APPLIED ECONOMICS

J. H. DODD

1946

APPLIED ECONOMICS

ELEMENTARY PRINCIPLES OF ECONOMICS
APPLIED TO EVERYDAY PROBLEMS

THIRD EDITION

by

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Published by
SOUTH-WESTERN PUBLISHING COMPANY
Cincinnati New York Chicago Dallas San Francisco

G33

K246

Printed in the United States of America

PREFACE

APPLIED ECONOMICS is the third edition of a textbook that has been widely and successfully used for a number of years for courses in elementary economics. In the first two editions the title was *Introductory Economics*. The present title is more appropriate for this third edition because of the increased emphasis upon practical, everyday applications of basic principles.

As a result of the friendly suggestions of teachers and students who have used the first two editions, a number of improvements have been effected in the organization and the treatment of the materials. The content has been largely rewritten and brought up to date. New topics, as well as a new chapter on co-operative societies, have been added. Where possible, the language of the text has been simplified and clarified.

The following are the outstanding features of APPLIED ECONOMICS:

(1) The fundamental principles of economics are presented in such a manner as to be meaningful and intelligible to the beginning student. A text that omits or treats too superficially the elementary principles of economics that are basic in most of the problems of the day is of little or no value. Unless the student secures a grasp of these principles, the time spent in the course is largely wasted.

(2) The style and the language of the discussions are simple and direct. New terms are explained as they are introduced. At the same time, the author has avoided the discussion of materials that are not pertinent to the principles under consideration. Careless and spectacular statements that lack validity are not used for the purpose of exciting attention.

(3) Suitable and attractive illustrations have been used wherever possible. They serve to supplement and to emphasize certain points in the discussion in an interesting manner. They cannot be used, however, as a substitute for a full discussion of basic economic principles and problems.

(4) Numerous activities of several kinds are suggested at the end of each chapter for regular or extra-credit assignments. The best way to arouse and maintain interest in a class in economics is by the application of the principles studied to current economic problems of personal and local significance. It is impossible for any textbook to provide all the materials that can be profitably utilized by students; but the teacher will find that the activities included in this book will suggest additional activities that may be undertaken by the class.

(5) A carefully selected bibliography is given in the back of the textbook. These varied references, which are appropriate for young students, are arranged by chapters. They do not merely repeat the textbook discussion. Only reference materials that can be understood by beginning students are included.

(6) In keeping with the idea that the principles learned in class have meaning only to the extent that they are applied in the lives of the student, a workbook has been prepared for use with the textbook. This workbook serves two purposes: (a) to provide the student with a convenient and interesting means of testing his understanding of the textbook discussion; (b) to provide materials for applying theoretical knowledge and factual information to everyday problems.

The author would like to express his indebtedness to all of those who have helped in supplying materials and suggestions that have contributed to the improvement of the present edition. These individuals include business men and women, professional people, teachers, and students. It seems impracticable to enumerate all of them, but they are remembered individually. He would be ungracious indeed, however, if he did not here acknowledge his indebtedness to the following: Dr. O. C. Ault, Professor of Rural Economics, George Peabody College, for his criticisms of the previous editions; Mr. A. A. Charles, a departmental colleague and an experienced teacher of high school economics, for reading and criticizing the manuscript; and his wife, Dr. Eileen Kramer Dodd, Professor of Psychology, Mary Washington College, for her help in the preparation of the correlating workbook.

JAMES HARVEY DODD

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TO THE STUDENT

In this course you will learn the principles involved in solving your problems of making a living and satisfying your numerous wants. To get as much out of this course as possible, you will need to be systematic in your study methods. The following suggestions for each chapter assignment are given to supplement those that your instructor will probably give you.

First of all, read the entire chapter rather rapidly so that you can get an over-all idea of what is included. Then you will be ready to study the material more intensively, giving special attention to the definitions, the explanations, and the examples of new economic terms. These terms are indicated in *italics*.

Many students find that they learn more efficiently if they put something in writing as they study. Such writing may take the form of notes or an outline. It is a simple matter to outline each of the chapters in this book because the different styles of type used for the headings indicate their relative importance. For example, the heading "Our Wants Are Many and of Different Kinds" on page 3, in boldface type, indicates that it should be a main heading in an outline. First subheadings are indicated by boldface italics, such as "Problems of Supplying Goods and Services" on page 7. In some chapters second subheadings are used; these are in plain *italics*.

By using the headings, the following skeleton outline can be drafted for Chapter 1.

Our Wants Are Many and of Different Kinds
We Have Four Kinds of Desires
Problems Arise from Our Efforts to Gratify Our Wants
  Problems of Supplying Goods and Services
  Problems of Exchanging Goods and Services
  Problems of Dividing Goods and Services
  Problems Pertaining to the Use of Goods and Services
The Study of Economics Is Interesting and Valuable

By adding a brief explanation for each of these headings in the skeleton outline, you should have an outline that will be helpful to you in mastering the contents of the chapter.

Each chapter is followed by four kinds of material. The *Questions on the Chapter* are based directly upon the information in the chapter. You should use these questions, therefore, as a check on your study. The last question in the group includes the new economic terms that have been introduced in the chapter. It is not necessary that you memorize the definitions or explanations of these terms exactly as they are given in the textbook discussion, but you should be able to explain satisfactorily in your own words what these terms mean and to pronounce and spell them.

If you are using the workbook that correlates with this textbook, you will find for each chapter a set of questions in the form of a study guide or instructional test. Your instructor will indicate whether you should answer these as you study the chapter or after you have completed your study.

The *Applications of the Chapter* provide you an opportunity to apply what you have learned to situations and problems that, for the most part, have not been discussed directly in the textbook. These call for careful study and, in some cases, you will need to secure information from other sources. On pages 537-546 you will find suggested reference readings for each chapter.

The *Topics for Special Reports* are designed for your use if you are able to complete the regular assignment in less time than is set aside for it. Your instructor will indicate whether your report should be in written or oral form.

The *Problems for Discussion or Informal Debate* require the participation of one or more students on each side of the question. You should prepare a brief statement of the best reasons that you can think of to support your answer of *yes* or *no* to the question so that students who listen to the discussion can decide for themselves which is the better answer to the question.

You will gain the most from your study of the course if you will apply what you are learning to yourself, to members of your family, and to your friends. A textbook cannot do that for you; that is something you must do for yourself, and it is one of the most valuable things you can do in your study.

UNIT I

The Nature of Economics

Problems of making a living
and of satisfying our wants as
consumers.

Studebaker Corpora

CHAPTER 1

WHAT WE STUDY IN ECONOMICS

The first day of the new school term was over. Dick Carston and Betty Wilson were on their way home and, as they walked along, Dick said, "I was just thinking how nice it would be if I had a car. But I guess everyone wants things he cannot buy."

"I certainly do," replied Betty. "And talking about wanting a car reminds me of what Mr. Ashton said in economics class this morning. You remember he said that economics is the study of what people want. It sounds like a big subject, doesn't it?"

"It certainly does," agreed Dick, "but it would have to be a big subject to cover all of my wants."

"Seriously, Dick," said Betty, "I think we need to know more about the topics Mr. Ashton said we will study. . . ."

"Well," interrupted Dick, smiling, "if you want to be serious let's see whether you learned your first day's lesson. What did Mr. Ashton say was a good definition of economics?"

"I don't remember exactly what he said," laughed Betty, "but I do remember that he said economics is a study of our problems in trying to make a living. And he said we would study things like wages and labor unions, prices, and taxes."

Betty could have added a number of topics to her list of things that are studied in a course in economics, such as production, marketing, money and banking, rent, interest, profits, government, and social security. All of these topics are included because *economics* is a study of our wants and of the problems that arise in connection with our efforts to get the things we want.

Our Wants Are Many and of Different Kinds. Just what are the things we want? It is impossible to list all of the things we might enjoy. A great many of our wants, however, can be satisfied in one of two ways: (1) by the use of *material things*,

such as food, clothing, and shelter, and (2) by the use of the *services* of others, such as those of entertainers, physicians, and teachers.

Some of our wants are for those material things and services that are necessary for existence. But our wants are not confined to these. And although we crave quantities of articles, we also want quality and variety. We want a sufficient amount of food, but we also like a variety of good food properly cooked. We want more than one change of clothing. And as styles change, we want new clothes, even though the clothes we have are not worn out. We may not be really vain, but we do crave the good opinion of others.

We Have Four Kinds of Desires. How can we explain all of our varied wants? In trying to answer this question, it is helpful to know that, in addition to our needs for food, clothing, and shelter, each of us has four kinds of wishes or desires: (1) the desire for recognition, (2) the desire for variety, (3) the desire for security, and (4) the desire for response.

The *desire for recognition* causes us to do many of the things we do. It is one of the reasons why we may like to wear stylish clothes, to live in a fine house, or to drive a big automobile. Or it may account for our desire to do a good job, to spend our lives in the service of others, or to lead the class in school. It is a strong motive in most people. It is, therefore, important that we use the desire for recognition as a motive force to drive us toward the accomplishment of worthy ends.

The *desire for variety* is nearly always present. We tire of staying in one place; we find it monotonous to keep doing the same thing day after day. We enjoy a change in food, clothes, work, play, scenery, and, sometimes, in associates.

The *desire for security* is often a strong motive for our actions. It is the reason we ordinarily dislike uncertainty. We do not enjoy the feeling of danger to ourselves or to others. If we think there is a possibility that we may be disturbed by intruders, we lock the door. When we buy an automobile, we want one that is not likely to give us trouble within a short time. Every prudent person is interested in saving and providing for his needs when sickness or old age will make it difficult

Paramount

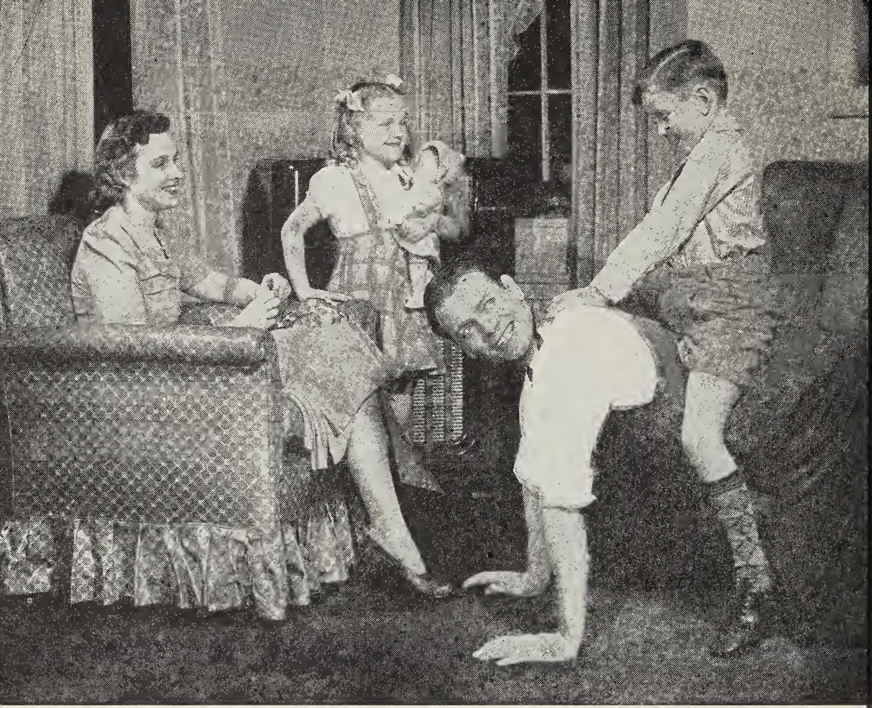
Rehearsing a Scene for a Movie

The desire for recognition is one of the most important reasons why movie stars work hard for success.

or impossible for him to make a living. All these instances illustrate how the desire for security influences the conduct of people.

The *desire for response* is the craving for understanding, sympathy, appreciation, and love. Because we have enjoyed the response of our parents and other members of the family and because of the familiarity of the objects that are associated with home, we have learned to love the place we call home. And we value our close friends because they understand us and are responsive to our craving for personal associations.

If we examine any want a person may have, we are likely to find that one or more of these desires are present. For example, when a man works for success in his business, he may have a desire to gain recognition as a leader and a successful businessman. At the same time, he may be eager to provide security for himself and his family.



Ewing Gallo

Family Fun

Happy home life satisfies the desires for security and response.

Problems Arise from Our Efforts to Gratify Our Wants. If each of us lived on his own little island, as did Robinson Crusoe, getting the things we want would be a very different matter from what it is. Each of us would grow and prepare his own food, make his own clothes, and build his own house. The things that he could not produce himself, he would have to do without.

But we are not Robinson Crusoes. We live in a nation of about 140,000,000 persons, and we can travel over the world, which contains, we are told, about 2,200,000,000 people. Instead of setting about to produce all of the various things we want, we select one type of work to which we give our time and effort. One person produces a certain kind of farm product, another works in a mine, another runs a store, another works in a bank, another practices law or medicine or performs some other service. Each usually receives pay in the form of money; and with the money, he buys what he wants or can afford.

Most of those who are employed are engaged in producing goods or services that, for the most part, are to be used by others. The money that is received for goods or services is wanted only because it will enable the owner to buy things from others. All producers, therefore, are engaged in the co-operative undertaking of producing goods and services, although usually their ultimate concern is to earn money.

Problems of Supplying Goods and Services. Of the material things we need to satisfy our wants, some are to be found in abundance, but not many. Under most conditions there is plenty of sunshine and air. Such things are free, and we take them for granted.

But of food, clothing, shelter, and the thousand and one articles that are needed to make modern life possible, there is not enough to be had without considerable effort. Here in the United States, nature has been generous in supplying us with the materials from which to make nearly every conceivable kind of article we may want. We have the raw supplies in greater abundance than do people in other countries. But before the natural resources can be used, it is necessary that they be made into goods.

The greater part of the job of making goods and providing services in the United States is carried on by private persons and business concerns. That is to say, most farms, mines, factories, stores, transportation companies, barber shops, beauty parlors, and other businesses are owned by persons or by groups of persons organized as business enterprises. The owners of private business concerns expect to make a profit by providing goods and services. On the other hand, many services and goods, such as police protection, education, and highways, are provided through our government.

Many problems arise in the management of a private business enterprise. The successful owner must first decide what kind of goods or services to provide. He cannot afford to produce something that the people will not buy. He must be able to sell what he offers at a price that the people can afford to pay and that will also leave him a reasonable profit; otherwise he will lose what he invests in the business. If he is to succeed financially, he must know where and when to buy machinery,

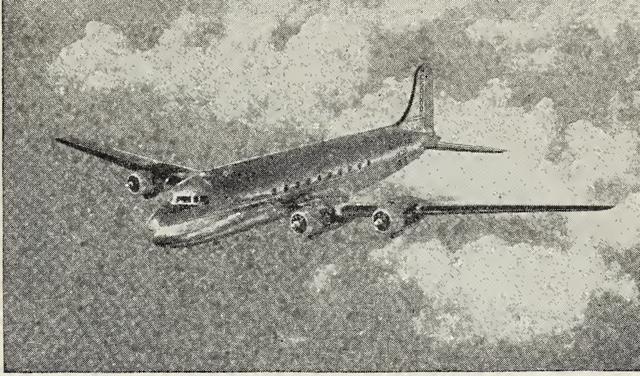
materials, and supplies and how to pay his employees so as to encourage them to render a reasonable amount of service. He must know how much labor and equipment should be used in order that his costs may be kept as low as possible. He must have expert knowledge of how to market what he has to sell. And he must take the risk of losing a part or all of the money he has put into the business. These are only a few of the problems with which the businessman has to deal.

Problems of Exchanging Goods and Services. Where people specialize in making goods and providing services, a great deal of buying and selling is necessary. There are more than 184,000 factories, over 6,000,000 farms, and millions of other concerns that are engaged in making goods and providing services for sale. Since all of us depend upon others to make most of what we need and want, it is vitally important that the buying and the selling of products and services be carried on with as little waste and interruption as possible.

Exchanging or marketing goods and services requires the work of many kinds of business concerns. We find retail stores of many kinds, roadside markets, public markets, wholesale concerns, railways and other kinds of transportation, storage companies, auction companies, banks, insurance companies, grain and other commodity exchanges, and other kinds of businesses, all of which are used in the exchange of goods and services.

There is no one best and cheapest way for marketing all kinds of goods. Although a great deal of progress has been made in improving the methods and means of marketing, each person who has something to sell must be constantly on the watch for a better method of getting his product to the person who will finally use it. The price that the user pays must cover the cost of marketing, as well as manufacturing costs. The alert businessman who is able to devise a less expensive and better way of marketing his product will be able to undersell his competitor, and the purchaser will gain.

Problems of Dividing Goods and Services. Since nearly all persons who work are co-operating in the production of goods and services, the important question arises, How much of the



Passenger Plane

Many economic problems arise in providing airplanes to satisfy the desire for variety through travel.

American Airlines, Inc.

goods and the services produced should each one receive? Is the work of the coal miner or cotton farmer any less important than that of a banker? Is the work of a noted movie actress more worth while than that of the stenographer? Why does a professional baseball player receive many times more than does a farm hand? Why does the engineer in a factory receive less than the manager or the president of the company? If the presidents of large concerns, like General Motors, General Electric, and the Pennsylvania Railroad, were paid no more than day laborers, would business be carried on as well as it now is? These are some of the interesting and perplexing questions that arise in the division or distribution of what is produced in the nation.

One might say that each should receive all that he can get. And many people do have that attitude. But as people come to understand that nearly all production results from the cooperation of all producers, more attention is being given to the problem of justice in the distribution of the products of industry.

As we have said, most of us are not paid "in kind" for our services in production; that is, we are not paid in goods or services that we produce or help to produce. Rather we are paid in money, and money is purchasing power. With the money we receive we can obtain part of what has been produced by others. Thus our share of goods and services is determined by the amount of money income that we receive.

Problems Pertaining to the Use of Goods and Services. When one buys a pair of shoes, a loaf of bread, or almost any other kind of article, he is likely to regard it as a matter of his own concern. He may exercise little judgment in his choices,

but that is his own business, we say. He may spend too much for one class or kind of goods and too little for another; but that, too, is his affair.

On the other hand, what one buys affects others also. In the long run, what people buy determines what will be produced. For this reason, someone has been moved to say, "The consumer is king." If many consumers desire a kind of product and have the money with which to buy it, producers will build plants and provide equipment and employ workers to produce it. For example, within the last few decades millions of dollars have been spent to build automobile plants, and hundreds of thousands of persons have found employment because most people wanted automobiles. At the same time, owners of carriage and buggy factories saw their businesses rapidly disappear as people changed from horse-drawn vehicles to automobiles. And as the demand for carriages decreased, thousands of workers either found themselves without employment or were forced to find other jobs.

The use of goods, therefore, creates many problems. In the first place, one's chances of finding the greatest degree of satisfaction from the use of goods and services depends upon what he has learned to want and upon how wisely he buys and uses the goods and the services that he wants. In the second place, what the consumer buys has a far-reaching effect on the work and the welfare of others.

The Study of Economics Is Interesting and Valuable. In the study of economics we are dealing with matters that are of vital concern to everyone. Wants and desires are the driving force behind our actions. We derive pleasure and contentment from the satisfaction of our wants. And since economics deals with wants and the problems that arise in connection with our efforts to satisfy wants, you should find the study interesting.

A study of economics is of great value to you. You will learn facts that will aid you in understanding many personal and business problems. Most of our social and governmental problems are largely economic in their nature. The conditions that brought on the World War that began in 1939 were largely economic. The speeches of candidates for public office and

the news articles of the day usually contain references to economic matters. And finally, if we are to succeed in making this a better nation and the world a better place in which to live, we must solve a great many problems that are economic in nature.

NOTE: Have you read "To the Student" on page vii? If not, do so now before continuing your study of this chapter.

QUESTIONS ON THE CHAPTER

1. How is economics concerned with making a living?
2. In what two ways are most of our wants satisfied?
3. Give an example of each of the four kinds of wishes or desires mentioned in the chapter.
4. To what extent are we dependent upon others in satisfying our wants?
5. How is the problem of scarcity of natural resources related to a study of economics?
6. What types of problems arise in the management of a business enterprise?
7. What types of business concerns are engaged in exchanging goods or services?
8. Explain this statement: "Most of us are not paid 'in kind' for our services in production."
9. How does your purchase of goods affect production in general?
10. Why is the study of economics valuable?
11. What is the meaning of each of the following terms?

    (a) **desire for recognition**
    (b) **desire for response**
    (c) **desire for security**
    (d) **desire for variety**
    (e) **economics**
    (f) **material things**
    (g) **services**

APPLICATIONS OF THE CHAPTER

1. Most news items relate to the business of making a living; that is, most of the news of the day concerns the making of goods, the exchange of goods, the income that individuals receive, and the use of goods. As a rule, you will find that the news items deal specifically with such matters as prices, wages, labor unions, strikes, money and banking, the condition of business, the amounts of different kinds of goods produced, foreign trade, government control of business, insurance,

social security, capitalism, socialism, transportation, jobs and unemployment, rents, housing, the conservation of land, as well as many others. As you know from reading Chapter 1, these events and conditions are largely economic in nature. Select ten news items from a daily paper. Which of the items are economic in nature and which are not?

2. If each of us tried to provide for all his wants, instead of buying from others most of the things he needs, how would our economic problems differ from what they are now?
3. How is the saying, "The love of money is the root of all evil" related to the subject matter of this chapter?
4. Ellen and Frank were discussing the subject of money. Ellen said, "If you have enough money, you can have everything you want." Frank replied, "I don't agree. Money is only a means to an end. And it is only one means." What do you suppose Frank meant?
5. Everyone craves pleasant experiences. But why is it foolish for one to adopt as his motto, "Eat, drink, and be merry, for tomorrow you die"?
6. What are the things that make a nation great? Can a nation be wealthy and not great?
7. The United States is the richest nation in the world. Is there any reason why there should be any poverty here? Do you think all poverty will finally be eliminated?

TOPICS FOR SPECIAL REPORTS

1. How my wants will probably change in kind and number in the next ten years.
2. How other people influence our wants.
3. Why Adam Smith has been called the "father of the science of economics."
4. Which desire or wish do you think was most important in causing the following persons to become famous or infamous? Alexander the Great; Julius Caesar; Christopher Columbus; George Washington; Napoleon Bonaparte; Thomas Edison; John D. Rockefeller; or any character in the news at the present time.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is the desire for recognition the strongest of the four desires?
2. Does "trying to keep up with the Jones's" encourage industry and lead to happiness?

CHAPTER 2

MAKING A LIVING

When young George Washington was surveying land in Virginia at the age of seventeen, the problem of making a living was different from that of today. Nearly one hundred years later, when Abraham Lincoln was splitting rails with which to fence his father's farm in Illinois, the question of what to do to make a living could be answered in a large measure in the way that it could in the days of Washington's boyhood. A majority of the people in those days obtained the things they used by growing wheat, corn, vegetables, and livestock; by building barns and fences; and by making crude tools with which to work. In many cases a considerable amount of food was obtained by hunting and fishing. For a long time in the early history of this country the people lived close to the soil, and they realized how dependent they were upon nature.

Today there are hundreds of occupations in which people are engaged in making a living. At the beginning of World War II, the most important groups of occupations in which individuals were engaged were manufacturing, farming, and wholesale and retail trade. The remainder of the working population was employed in personal services; professional services; transportation, communication, and other public utilities; construction; government services; finance, insurance, and real-estate operations; mining; business and repair services; and amusement and recreation.

Ways of Making a Living Change. We often hear it said that we live in the "industrial age," the "age of business," or the "factory age." Sometimes one of these terms is used, and sometimes another. What is meant is that we live in a time when a great many people work in factories, transportation industries, stores, mines, and in various other places where machinery and mechanical power are used or where buying and selling are carried on.

By an *economic age,* or *stage,* we mean a time in the history of the race when a certain way of making a living is characteristic of the time. At one time hunting and fishing were the means used by most of the people in getting the things they needed. Hunting and fishing and gathering fruits and other forms of wild food were the earliest ways of making a living. This period in the history of the race is often referred to as the *hunting and fishing stage.*

Our present complex economic age evolved from the hunting and fishing form of making a living through a pastoral, an agricultural, and a handicraft stage, into the industrial stage. By the *pastoral stage* we mean the time when people came to depend largely upon flocks and herds of cattle and other animals for a living. The *agricultural stage* refers to the time when wild grains and other plants had become domesticated, so that they could be cultivated in fields. When people had learned how to cultivate plants of different kinds, they came to depend for a living more upon agriculture and less upon the keeping of herds of cattle and hunting and fishing. Eventually some people acquired skill in making clothing, furniture, weapons, candles, saddles and harnesses, and various kinds of articles, so that many of them could make a living in this way. That was before the time of machines and steam power, and everything had to be made by hand. This period is known, therefore, as the *handicraft stage.*

Finally, when machines and steam and other forms of mechanical power came into use, it became customary to refer to the latest stage of economic evolution as the *industrial stage* or some such term to indicate that machines, power, and the exchange of goods play so important a part in the lives of the people.

We should not imagine that any one of these stages ended abruptly. The change from one stage to another was gradual. Indeed, we can still find instances where people make at least a part of their living by the use of each of the methods that we have indicated above.

The Hunting and Fishing Stage. A long time ago our ancestors were directly dependent upon nature for a living. There

were no stores from which to obtain goods. There were no livestock nor farms, for animals were wild and untamed, and man had not learned how to cultivate plants. Earliest man, therefore, obtained his living by hunting and fishing and by gathering wild fruits, nuts, berries, and other things that could be eaten. What clothing he wore was made from skins of animals, the bark of trees, and grass. Since people had not learned how to construct tents or houses, they lived in the open and found what shelter they could in caves and other secluded places. In some parts of the world today savages still live in the hunting and fishing stage of existence.

The Pastoral Stage. Just how long man lived entirely by hunting and fishing and gathering wild food, we do not know. Probably it was a very, very long time. Eventually, however, man's intelligence and dislike for work caused him to consider other ways of getting a living. Instead of having to chase and

A Reminder of the Pastoral Stage

In this economic stage families and tribes accumulated herds and flocks of animals.

U. S. Department of Agriculture

kill an animal every time he wanted meat, he came to see that it would be more desirable to capture and keep a number of animals in captivity. Some of the captured animals no doubt became less wild as they grew accustomed to human associations. This was probably true especially of those that were captured while they were very young and of those that were born in captivity. Finally, some of the animals became so well adapted to living near human beings that it was no longer necessary to keep them closely confined. They had become domesticated.

As time went on, families and tribes accumulated herds and flocks of animals. Thus the source of food supply became less uncertain. Although it was necessary for the owner of cattle to move occasionally in order to find better grazing for his animals, people began to live a more settled type of existence. Tents were used for shelter. Then, too, more thought was given to making crude kinds of bedding and articles of furniture and to weaving cloth.

In the pastoral stage some trading was carried on, but not much. There was little or no money. The usual method of exchange was that of "swapping," or barter. Perhaps slavery began during the hunting and fishing stage, but it became common in the pastoral stage. There were no large cities and few villages. People lived in families and small groups.

The Agricultural Stage. After many people had adopted the pastoral way of living, the domestication of grains, fruits, and vegetables followed naturally. The necessity for supplying the herds with food led to the raising of hay and other foodstuffs. And by cultivating wild grains and vegetables, people increased their security in the way of a food supply. In this way the agricultural stage was ushered in.

People now began to build houses and to live in villages or manors. Some individual became the leader, and the people looked to him for protection. The leader lived in a large house or castle. He became the feudal lord to whom all the villagers owed obedience and loyalty. The villagers were given the right to use certain strips of land, and in exchange for this right they were required to perform duties for the lord of the manor. These duties included working a certain number of days in

his fields. The land that a tenant, or serf, cultivated for himself was usually not in one place but was in alternate strips in the field, so that all might have a chance to share in the best land. In each village there was a mill for grinding grain, a blacksmith's shop, and a court of law.

There was a wide social gulf between the lord and his serfs. But as between the serfs themselves there was little social inequality. Each village was largely self-sufficient, with little buying and selling outside of the community. There was not much competition in trade, since there were few goods to be exchanged and money was not often used.

The Handicraft Stage. Under the manorial system agriculture was the principal way of making a living, while manufacturing was of little relative importance. In the latter part of the Middle Ages, however, on the continent of Europe and in England, towns increased in number and size. With the increase in the size of the towns there came an opportunity for persons of ability to develop a high degree of skill in making various kinds of articles. Some specialized in the making of shoes, others in furniture, others in weaving cloth, and so on. Thus began such occupations as that of the baker, tailor, cobbler, carpenter, candle maker, and others. At first the products were sold to the townspeople, but later they were sold to those living in other communities.

Merchant and Craft Guilds. As the number of manufactured articles increased, trade grew in importance. The craftsmen became traders also. They formed organizations called *merchant guilds.* At first, one of the main purposes of the merchant guild was to provide mutual protection from robbers. Later these organizations undertook to monopolize trade and to control competition. Thus the attention of the merchant guilds was centered on the problems of marketing goods. These guilds regulated all kinds of trade.

As time went on, the number of shoemakers, cabinetmakers, and other specialized craftsmen increased. The increase in the number of workers and in production gave rise to new problems relating to production. Therefore the craftsmen in each branch of production formed organizations for the regulation of

the training of new workers, standards of quality of their products, methods of assisting unfortunate members, and other things. These organizations were called *craft guilds.* Each guild was given complete control of production in its line of work, and it was supposed to see to it that standards of quality were maintained by all guild workers.

In order to secure skilled workers and to limit the number of those admitted into a trade, each guild had an *apprenticeship* system. Under this system youths were required to serve under a master workman for a number of years. At the end of the required period of training, which was often seven years, the apprentice was supposed to be a skilled worker. He might work for wages as a journeyman and eventually, if his skill increased, he might become a master workman.

The Domestic System. During the handicraft stage manufacturing was done by hand. In fact, the word "manufacturing" comes from two Latin words, *manus*, meaning "hand," and *facere*, meaning "to make." Tools were simple and few machines had been invented. Although some workers became highly skilled artisans and produced some fine pieces of workmanship, the number of articles manufactured was relatively few.

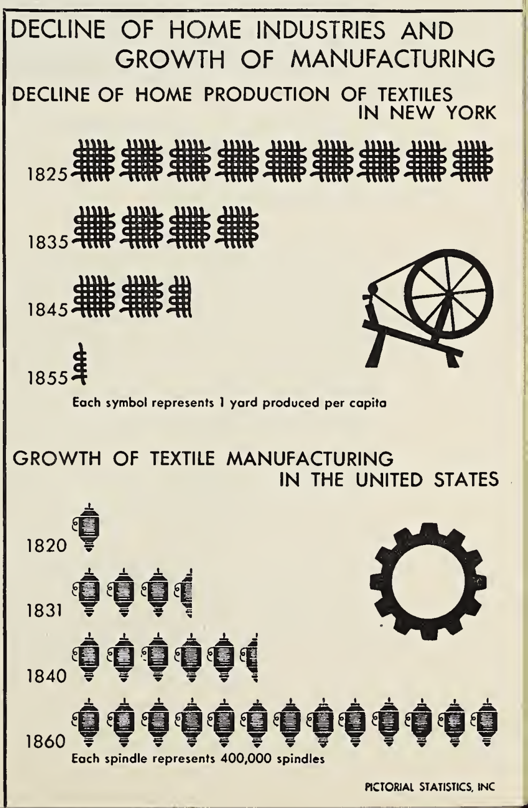
Later on, say about the fifteenth century, the strength of the craft guilds began to decline. Two main reasons account for this. In the first place, the craft rules were rigid. The opportunity for an apprentice or a journeyman to become a master workman was very limited. Many who hoped to attain this coveted position were never able to do so. As a result, an increasing number of those who had acquired considerable skill endeavored to set up shops of their own and to evade the control of the guilds. To do this was not always easy, for the attempt was illegal. Nevertheless, many succeeded in doing so, because there was a growing demand for goods that the guilds would not or could not supply at prices the people were willing to pay.

In the second place, the number of *capitalists*, those having money to invest, became greater. These persons would buy goods wherever they could obtain them, whether the goods were made by regular craftsmen or by others. Then they would endeavor to sell the goods at a profit. Thus these capital-

ists became middlemen. Often they contracted with workmen for quantities of goods, an arrangement that solved the workman's marketing problem. In many cases they paid the workmen stipulated amounts for their services. Frequently they supplied them with raw materials, and, later on, it was not unusual for them to furnish the workmen with the tools they needed, for which rent was paid. Work was done in the workmen's homes or shops, and for that reason the practice is sometimes referred to as the *domestic system.* Because the contracts were let and the materials were often furnished, the practice is also called the *putting-out system.*

By the seventeenth century some of the capitalists began to build large houses where the workers were brought together. It is true there was little machinery in these "factories," but the movement toward the centralization of workers marked the real beginning of our modern mass-production methods.

The Industrial Stage. It is sometimes said that the handicraft age lasted until about the middle of the eighteenth century, or to about 1760. The reason this date is chosen is that after 1760 a number of important inventions occurred that revolutionized manufacturing and resulted in what we now call the industrial or factory age. This date, however, is used only for convenience in discussion, because, as we have said, no one economic stage ended suddenly.

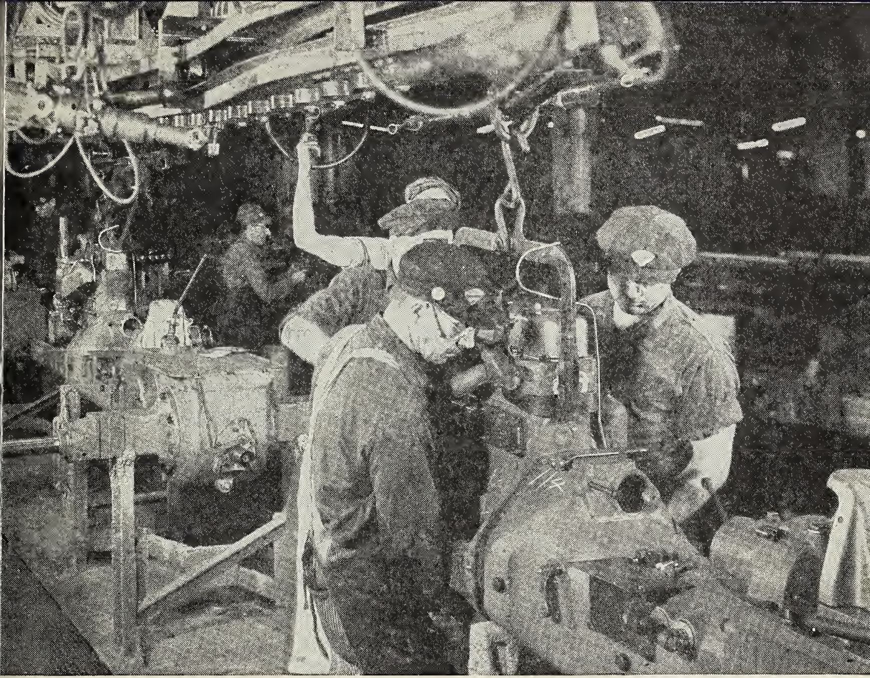


From 1764 to 1785 three inventors in England—Hargreaves, Arkwright, and Crompton—patented several inventions for the spinning and the weaving of cloth. And in 1769 James Watt improved the steam engine so that within a few years steam was used in place of men, horses, and water as a source of power for manufacturing. These inventions and the thousands of others that have followed since have made it possible to manufacture goods of all kinds in great quantities and with far less effort than was formerly possible. The inventions and the perfection of machines and the use of power resulted in the establishment of factories and the production of goods on a far larger scale. The use of machines and mechanical power and the establishment of factories produced such far-reaching changes in the ways of making a living that the period covering the last part of the eighteenth and the first part of the nineteenth centuries is referred to as the time of the *Industrial Revolution.*

The change to the use of machinery and power in manufacturing occurred first in England. Soon, however, the new methods in manufacturing spread to this country. By the time of the War of 1812 America, too, had entered the industrial stage, although we did not become primarily a manufacturing nation until years later.

The United States Has Become an Industrial Nation. For more than three quarters of a century after our nation was founded, a majority of our population gained a living from agriculture. Until about 1890 there was an abundance of fine agricultural land in the western states that was being taken by settlers from the eastern states and by immigrants from other countries. Therefore, while manufacturing began during the early years of our national history, agriculture did not quickly lose its relative importance as a way of making a living.

The disappearance of free farm land, the invention of labor-saving farm machinery—such as the mowing machine, reaper, and tractor—the improvements of farm plants and animals, and the growing demands for all kinds of manufactured products have brought about marked changes in the ways by which many of our people live. In our early national history it re-



International Harvester Company

Factory Workers

Millions of people today make their livings in factories.

quired the efforts of a majority of all those who worked to produce enough food and other farm products for all the people. At the present time only about one out of five of the working population is engaged in producing the agricultural products used by the entire population, in addition to a considerable amount that is sold to people in foreign countries. And it is possible that improvements in the methods of farm production in the future will require even less than one fifth of the working population to produce the farm products needed. If this is true, a greater proportion of the people will make a living in such fields as manufacturing, transportation and communication, business, and personal and professional services.

Making a Living Involves a Division of Labor. By *division of labor* we mean the practice whereby different individuals engage in different kinds of work. In the hunting and fishing stage every man was largely dependent upon his own efforts for

everything he needed. But as the race has passed through successive economic stages, specialization in production has increased. Where the division of labor is highly developed, individuals must rely upon some system of exchange for each one to get the things he needs.

Today in the United States we may classify those who work into the following major occupational groups: (1) agriculture, forestry, and fishing; (2) mining; (3) construction; (4) manufacturing; (5) transportation, communication, and other public utilities; (6) wholesale and retail trade; (7) finance, insurance, and real estate; (8) business and repair services; (9) personal services; (10) amusement and recreation; (11) professional services; and (12) government services. (See the table on page 23.)

In each of these groups are to be found many persons who devote all their time and effort to some one particular phase of work. For example, in a factory there are several departments. And in each department nearly every worker performs only a comparatively simple act. In a shoe factory some workers prepare the leather, others make the patterns, others cut out the shapes, others fasten the uppers to the soles, others attach the heels, and so on, so that in the making of a pair of shoes a total of more than two hundred operations may be performed.

Corn Husking

Today farming ranks second only to manufacturing in providing persons with a means of making a living.

Farm Security Administration

EMPLOYED WORKERS BY OCCUPATIONAL GROUPS AND SEX, 1940

Occupational Groups	Total		Male		Female	
	Number	Per Cent of Total	Number	Per Cent Male	Number	Per Cent Female
Employed in all industries (except on public emergency work)	45,166,083	100.0	34,027,905	75.3	11,138,178	24.7
Agriculture, forestry and fishing	8,475,432	18.8	7,988,343	94.3	487,089	5.7
Mining (coal, crude petroleum, etc.)	913,000	2.0	902,061	98.8	10,939	1.2
Construction	2,056,274	4.6	2,022,032	98.3	34,242	1.7
Manufacturing	10,572,842	23.4	8,250,590	78.0	2,322,252	22.0
Transportation, communication, and other public utilities	3,113,353	6.9	2,768,267	88.9	345,086	11.1
Wholesale and retail trade	7,538,768	16.7	5,509,228	73.1	2,029,540	26.9
Finance, insurance, and real estate	1,467,597	3.2	1,013,297	69.0	454,300	31.0
Business and repair services	864,254	1.9	787,377	91.1	76,877	8.9
Personal services, (domestic, hotel, laundering, etc.)	4,009,317	8.9	1,133,555	28.3	2,875,762	71.7
Amusement and recreation	395,342	0.9	316,063	79.9	79,279	20.1
Professional services	3,317,581	7.3	1,472,453	44.4	1,845,128	55.6
Government services	1,753,487	3.9	1,414,069	80.6	339,418	19.4
Industry not reported	688,836	1.5	450,570	65.4	238,266	34.6

NOTE: In addition to the number of persons included in the above table, there were in 1940, 2,529,696 persons employed on public emergency work, such as WPA and NYA. In the same year there were 5,093,810 persons seeking work. The total labor force in that year—employed and unemployed—was 52,789,499. This figure does not include 28,931,869 persons 14 years and older, principally women, who were engaged in home housework.

By 1944 the total number of employed persons was more than 60,000,000 of whom 17,000,000 were women.

Law and Economic Customs Affect Our Ways of Making a Living. The Industrial Revolution in the United States brought about or emphasized certain customs and practices that greatly affect our ways of making a living. An understanding of these customs and practices will help us to become better acquainted with the world in which we live. It will also help us to appreciate the causes and the nature of many of the economic and social problems with which we must deal.

Private Property. Everyone has something that he likes to call his own. The things that one can call his own may be only some wearing apparel and other personal articles; or they may consist of a fine house, land, an automobile, and a large number of other things. Most of us take pride and satisfaction in the fact that we have the exclusive use of these articles. So long as their use does not result in injury or inconvenience to others, we are free to use the things we own as we please.

The right to acquire, to use, to sell, to destroy, or to give away an article or a right is called *private property.* For example, if someone gives or sells you a football or a box of candy, you have the right to use it exclusively, so long as its use does not harm others. Likewise, when you pay your money for a theater ticket, you acquire the right to attend the show. And if you work for another under an agreement that he is to pay you, you acquire a right or claim against him to receive money. This right is also your private property.

Sometimes articles of wealth themselves, such as books, land, automobiles, or buildings, are referred to as property. Frequently it is convenient to use the term in this way. But we should always understand that there is a difference between an article of wealth itself and the right to use the article.

Private property is of tremendous importance in our social and economic order. It has existed for many centuries. But the coming of the Industrial Revolution made private property even more important than it had been before. In the first place, production under the factory system required the use of a great deal of machinery. Machines were scarce, and those who had them and used them in manufacturing could produce goods in greater quantities than those who had to produce goods by hand. There was an increased demand for iron and

other mining products for making machines; so that the ownership of mines and factory machinery became more desirable. Likewise, as the quantity of goods produced in factories increased, there was more need for ships and railroads to bring materials to factories and to carry goods to market. People who were fortunate enough to own an interest in a mine, a factory, a railroad, or a ship could earn an income without manual labor.

Freedom of Enterprise. *Freedom of enterprise* refers to the right of an individual or a group of individuals to engage in the production of goods or services, the production of which is not prohibited by law. Until the Industrial Revolution there were many restrictions upon the rights of individuals to engage in the production of goods and services.

In 1776, Adam Smith wrote a book, called *An Inquiry Into the Wealth of Nations*, that expressed certain ideas that were becoming popular at that time. It was Smith's argument that people should be free to engage in production. He contended that anyone who so desires and can, should be allowed to produce goods that are wanted by the public. Thus, thought Smith, freedom of enterprise would result in the use of natural resources, machinery, and labor for the production of goods and services that the people want. He, as well as most businessmen and lawmakers at that time, argued that government should leave business largely free to control itself.

The ideas expressed by Adam Smith constitute a philosophy with regard to business that is known as *laissez faire*. This means a "let alone" policy. According to the theory of laissez faire, government should do little in the way of fixing minimum wages, passing laws for the regulation of working conditions, or for controlling competition.

At no time, however, has business been absolutely free from some control by government. It has always been necessary to have some laws for the regulation of business and trade. But during the last fifty years, and especially during the last twenty-five, there has been an increasing amount of government regulation of business affairs. The old idea of freedom of enterprise and competition has been greatly modified.

Freedom of Contract. In law a *contract* is an agreement that can be enforced in court. All agreements are not contracts, but all contracts are agreements. A mere social agreement, to call on another, for example, is not a contract. Usually an agreement to work for another or to buy or to sell goods, however, is a contract, and a person breaking such an agreement may be called into court and made to pay damages if it is proved that his failure to keep his promise resulted in loss to the other party to the contract.

When your mother orders groceries, she enters into a contract. Transactions with banks, merchants, workmen, and all sales of goods or services are based upon contracts. Without the use of contracts, which can be enforced in courts, business could not be carried on as it is today.

The law permits anyone who is of legal age and of sound mind to enter into contracts. So long as one enters into a contract of his own free will and accord, he must live up to his agreement, even if he suffers financial loss. This rule takes it for granted that everyone who is of legal age and sound mind should be able to enter into agreements for the conduct of his business affairs.

Freedom of Competition. Closely related to the ownership of property is the right of a person or business concern to sell goods or services at any price that may be agreed upon. Those who hold that there should be free competition argue that competition will work out for the good of the mass of the people. It is said that if manufacturers and other producers are allowed to compete, each producer will keep his prices as low as he can in order to sell his goods and make a profit, and for this reason consumers will not be compelled to pay unreasonably high prices. It is held that the desire of producers to sell their goods at as high a price as possible will be matched by the desire of consumers to buy at as low a price as possible. As a result, so it is said, the prices at which the goods will sell in the market will be fair, both to producers and consumers.

The Profit Motive in Production. Under our system of capitalism, business is conducted primarily for the purpose of making a profit for the owners. The desire to make a profit is

the main incentive of all those who organize and conduct business enterprises, including farmers, merchants, bankers, manufacturers, and others. The greater the possibility of making a profit in a given type of business, the more eager individuals are to engage in that kind of enterprise. On the other hand, the less encouraging the prospects of profits, the fewer are those who are willing to risk their money and energy in an enterprise.

Since the making of profits is the primary incentive in production, it is not surprising that the pursuit of profits by producers does not always result in the greatest possible degree of prosperity for all the people over long periods of time. Just how the undesirable consequences of producing goods primarily for profit can be avoided is one of the pressing problems of our times. It is a question that is involved in many of the political issues that are frequently discussed.

Our Economic Order Is Capitalism. Taken together, the ways of making a living and the customs and the laws relating to economic matters are spoken of as the *economic order*. There are, or may be, several kinds of economic order, including capitalism, Fascism, Nazism, socialism, and communism. *Capitalism* is the economic order under which we live. It is also the economic order that prevails in Great Britain, including all the dominions that make up the British Empire, and in most of the other countries of the world. Later we shall study the kinds of economic order in detail.

The foundations of capitalism are (1) private property and (2) the profit motive in the conduct of business and industry. Supporting these are the legal rights of free contract, free enterprise, and competition in business. Capitalism takes it for granted that in business people act mainly from motives of self interest. This does not mean that everyone is always moved by a low, crude form of selfishness. Nor does it imply that there are no restrictions by government on business. The attitude of modern businessmen, however, is that there should be no more control by government than is necessary and that business should be given as much freedom as possible.

Capitalism also holds that everyone who contributes to the production of goods and services should receive an income

somewhat in proportion to the value of his contribution to the production of the national income. Thus the landowner is entitled to rent; the owner of machinery, tools, and other equipment used in business and industry is entitled to interest and profits for the use of his property; and people who contribute their labor are entitled to wages. The more valuable one's contribution to production, the larger his income should be. Most of our study in connection with the following chapters will be devoted to the conditions under which people make a living under capitalism.

The Ways of Making a Living Will Continue to Change. In 1820 more than 70 per cent of the nation's labor force was engaged in agriculture. One hundred years later, in 1920, the percentage had fallen to about 27. In 1940 less than 19 per cent of all gainfully employed persons in the United States were engaged in agriculture, forestry, and fishing. On the other hand, from 1820 to 1920 there was a gain in the number of persons engaged in manufacturing pursuits. From 1920 to 1940, however, there was a slow decline in the percentage of the nation's labor force engaged in manufacturing. Of course, just before and during World War II the number engaged in manufacturing greatly increased.

During times of peace there has been a tendency for a relatively smaller number of persons to engage in agriculture and manufacturing. At the same time, there has been a tendency for a relatively larger number to engage in other kinds of work. These other kinds of work include wholesale and retail trade, finance, insurance, real estate, repair services, personal services of all kinds, amusement and related services, professional services, and government services.

These tendencies are important for two reasons. In the first place, as time goes on, there will be more and more different methods by which people will make a living. The kinds of occupations will increase in number, so that one will have additional opportunities to choose work that is suited to his talents and liking. In the second place, the scale of living of most people should rise. More people will use more kinds of services and life should become more interesting and pleasant.

QUESTIONS ON THE CHAPTER

1. How has the problem of making a living changed most in the past two hundred years?
2. What is the meaning of an economic age or stage?
3. Through what economic stages has the race passed?
4. In which of the economic stages was man most self-sufficient? In which was he most dependent?
5. Distinguish between a merchant guild and a craft guild. What similar purposes led to their formation?
6. How did inventions tend to produce the industrial stage?
7. What were the causes that helped to make the United States an industrial nation?
8. In what fields of industry may specialization be found?
9. In what groups of occupations does the number of women workers exceed the number of men workers?
10. Differentiate between an economic stage and an economic order.
11. Why is each of the following considered a characteristic of capitalism?
    (a) private property
    (b) the profit motive
    (c) freedom of enterprise
    (d) freedom of contract
    (e) freedom of competition
12. What is the meaning of each of the following terms? Be sure also that you can spell and pronounce each of these economic terms.
    (a) **agricultural stage**
    (b) **apprenticeship**
    (c) **capitalism**
    (d) **capitalist**
    (e) **contract**
    (f) **craft guild**
    (g) **division of labor**
    (h) **domestic system**
    (i) **economic order**
    (j) **economic stage**
    (k) **freedom of enterprise**
    (l) **handicraft stage**
    (m) **hunting and fishing stage**
    (n) **Industrial Revolution**
    (o) **industrial stage**
    (p) **laissez faire**
    (q) **merchant guild**
    (r) **pastoral stage**
    (s) **private property**
    (t) **putting-out system**

APPLICATIONS OF THE CHAPTER

1. Explain why some occupations have become relatively less important while others have become relatively more important.
2. Discuss the effects that ways of living have had on education.

3. The following characters were outstanding during which stage of our economic evolution: Cellini; Andrew Carnegie; Jacob, the son of Isaac; Pocahontas; Priscilla Arden?
4. List five agreements that you believe would be contracts. Why should contracts be enforceable at law?
5. Give examples to illustrate that absolute freedom of contract might be undesirable.
6. In what cases might freedom of competition prove undesirable? Give reasons.
7. When people in your community produce or sell things for the purpose of making a profit, do the buyers of these goods secure any advantage? When might the profit motive result in disadvantages for the consumer?
8. Do you believe that the increase in the number of occupations will make it more difficult for a young person to find his job? Give reasons for your answer.
9. Explain why a strike that interferes with production in any industry is more important today than it was a hundred years ago.
10. How is income distributed under capitalism?
11. Give specific occupations as examples of each of the occupational groups as shown in the table on page 23; for example, construction—bricklaying; retail trade—cashiering.

TOPICS FOR SPECIAL REPORTS

1. The number and the percentages of those engaged in the main occupational groupings compared with those listed in those occupations in 1900.
2. How the government disposed of the land in the Northwest Territory and the land gained by the Louisiana Purchase.
3. The division of labor to be found in a local business establishment, such as a factory.
4. Instances in the local community showing that capitalism works as it is supposed to work.
5. Instances in the local community showing that capitalism does not always work as it is supposed to work.
6. The Roycrofters.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Have inventions tended to increase man's happiness?
2. Will more restrictions on private property and individual freedom become increasingly necessary in the future?
3. Should every person have some type of vocational training?

CHAPTER 3

EARNING AND USING INCOME

To most people today, making a living means earning an income in the form of money. Of course, they know that what they really need and want is goods and services, and not money. Experience, however, has taught us that, if we have enough money, we can usually get the goods we want. It is for this reason that when we think of making a living, we ordinarily think in terms of money.

Most young persons often find themselves thinking of what they will do to earn a living when they leave school. No doubt you have given this matter some consideration. You have probably wondered what kind of work you would like to do. And it is likely that you have tried to estimate the amount of money income you might be able to earn in various kinds of occupations.

But earning money is only one of the two important personal financial problems that confront individuals and families in modern life. Of importance, too, is the fact that money may be used economically or it may be used wastefully. If it is used economically and wisely, a relatively small amount will enable the owner to obtain as much or more satisfaction than a larger amount that is spent carelessly.

There Are Four Main Sources of Income. As a rule, one earns his income as compensation for his contribution to the production of goods. As we shall see later in our study, there are four principal ways by which individuals contribute to production. They may supply services in the form of labor, for which they receive wages and salaries. They may furnish land, for which they receive rent. They may supply capital or money, for which they receive interest. Or they may undertake the risks of business ownership for which, if they are successful, they receive profits.

What Factors Contribute to Earning an Income? It is generally assumed that the person who contributes most to the increase in the value of the goods that he helps to produce will receive the largest amount of money income. There are instances where this assumption is not valid. But it is ordinarily taken for granted.

Obviously if one uses his land or capital, or if he rents or loans it to another, he is likely to receive the greatest amount of income possible if his property is put to the most productive use. If he undertakes the ownership of a business, he will probably make the greatest amount of profit if he makes or sells goods for which there is the greatest demand. And if he works for wages or a salary, he stands the best chance of making a good income if he is efficient, industrious, dependable, and has a job in an occupation that is not overcrowded.

How Should One Select His Occupation? The selection of an occupation involves making one of the most important decisions that the individual is ever called upon to make. One's chances for earning a satisfactory income and for happiness are directly related to the kind of work he does for a living.

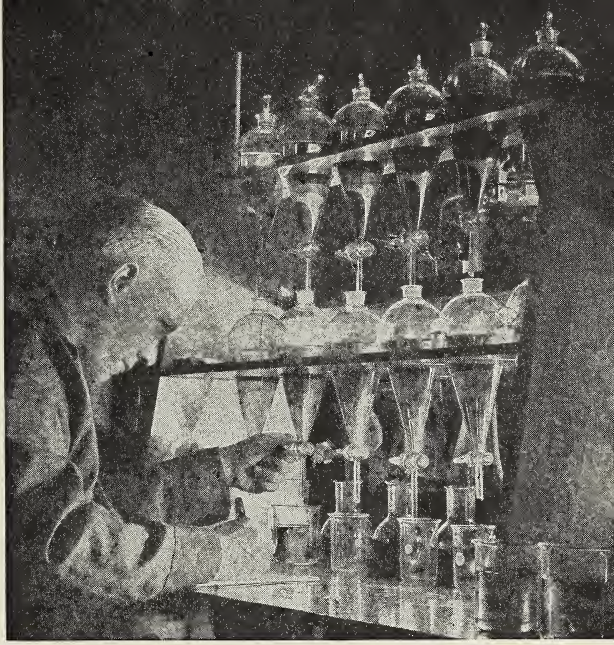
Unfortunately, the intelligent selection of an occupation is not an easy matter for most persons. There are a few individuals who seem to know from childhood exactly what they want to do. But they are exceptions to the rule. As most men and women can testify, one's ideas about what kind of work he would like best to do change from the time when he first thinks of the matter until he finally makes his decision.

This is not the place for an extended discussion of the principles and problems of vocational guidance. But it is appropriate to refer briefly to a few of the most important matters to which you should give thought in your efforts to decide what your lifework will be.

Aptitudes. The ability to do work exceptionally well is an important factor in one's success in any occupation. If one is to achieve more than ordinary success in any calling, it is imperative that he do his work better than the average person who is engaged in the same kind of work. For this reason everyone should attempt seriously to find out what his talents are.

A Chemist in an Oil Refinery

Modern industry provides opportunities for highly educated and trained individuals to make a living.



Socony-Vacuum Oil Co.

To discover the kind of work for which one has the greatest degree of aptitude is not always easy. At the same time, it is often possible to determine what aptitudes one does not possess. For example, a boy usually knows whether he is lacking in mathematical ability. If he is, it would probably be a mistake for him to attempt to prepare for a career in engineering.

There are certain tests that are designed to test the vocational aptitudes of individuals, such as those for selling, clerical work, and manual work. Educators, however, are not willing, as a rule, to concede that these tests are entirely reliable. One of the ways by which you can find out the kind of work for which you possess special aptitudes is by participation in games and sports, working on hobbies, doing actual work of various kinds, working in the school shop, doing Scout troop work, and participating in extra-curricular school activities, such as playing in the school band, debating, painting, and others.

Interests. One should select an occupation in which he has a real interest. For if he does not like his work, he will find little enjoyment in it, and his chances for promotion and success in his work will not be good.

If it were possible, one of the best ways for one to discover the kind of work he would like best would be to try out all the various kinds of occupations. Unfortunately, however, this is not possible. Still, as was suggested above in the discussion of aptitudes, one may participate as an amateur in several kinds of activities. As a result, he may be able to form a pretty good idea as to whether he would like a certain kind of work.

There are several tests that classify interests into occupational types including scientific, musical, computational, artistic, persuasive, literary, and social service. Many high schools are now using these tests in an effort to help students to discover their vocational interests.

Vocational Opportunities. It has been said that "there is always room at the top." That is, if one possesses rare ability and industriousness and does not encounter too much "bad luck," he can achieve outstanding success even in those occupations that are apparently overcrowded.

At the same time, the relative number of persons in an occupation is a factor that affects the possibilities of the average person for earning a satisfactory income. If a trade or industry is overcrowded, naturally it is more difficult for an additional worker to earn a satisfactory income than it would be if there were fewer workers. One of the best indications as to whether an occupation is overcrowded is the amount of the average income of those in the occupation.

Rehearsing a Radio Program

Radio provides vocational opportunities for those with dramatic talent.

The demands for workers in occupations change. In this connection it is interesting to study the trends that may be detected in various types of gainfully employed persons during the past forty years. The following table is taken from reports of the United States Census from 1910 to 1940.

GAINFUL WORKERS IN THE UNITED STATES ACCORDING TO ECONOMIC GROUPS, 1910–40

Group	Percentage			
	1910	1920	1930	1940
Professional persons	4.3	4.9	6.0	6.6
Proprietors, managers, and officials	22.5	22.0	19.8	20.4
a. Farmers (owners and tenants)	16.1	15.3	12.3	11.8
b. Wholesale and retail dealers	3.3	3.4	3.7	3.8
c. Other proprietors	3.1	3.3	3.8	4.8
Clerks and kindred workers	10.0	13.7	16.3	17.2
Skilled workers and foremen	11.4	13.4	12.9	11.6
Semiskilled workers	14.4	16.0	16.3	18.9
a. In manufacturing	9.6	10.5	9.3	8.9
b. Other semiskilled workers	4.8	5.5	7.0	10.0
Unskilled workers	37.4	30.0	28.7	25.3
a. Farm laborers	16.3	10.1	9.0	7.1
b. Factory and building construction workers	7.0	7.5	6.9	7.0
c. Other laborers	7.4	7.0	6.0	6.4
d. Servant classes	6.7	5.4	6.8	4.8

As you can see, in some groups the percentage of persons decreased during the period, as in the cases of farmers and farm laborers. In others, the percentage of workers increased, as in the cases of clerks and other semiskilled workers.

Of course, trends in occupational groups in the future and in particular kinds of jobs may not continue as they have in the past. This is a matter that calls for careful consideration of all the factors that relate to business and industry. These factors involve those that affect business and industry in other countries as well as those here in the United States.

One Should Prepare for His Occupation. As a rule, the more proficient one is in a particular kind of work, the more nearly certain he is of finding steady employment at good wages than is the average worker in the same type of occupation. It is important therefore that, after an individual has made a

careful selection of his occupation, he should prepare himself to do that work as capably as he can.

Training for employment should be both specific and general; that is, one should secure vocational training that will enable him to do well some specific job. At the same time, he should prepare himself to do a number of related kinds of work. For example, a boy who plans to become an expert auto mechanic should also learn something about electrical repair work, metal working, machine-shop work, and drafting. Then if it should become necessary or desirable for him to change from his work as a mechanic, it might be comparatively easy for him to secure work in a related field. Moreover, his wider knowledge and skill would make his work as a mechanic more interesting, and it might lead to important promotions.

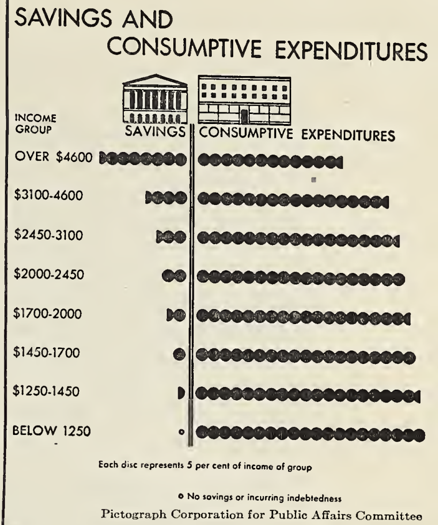
In any discussion of preparing for an occupation it is important to keep in mind the distinction that is sometimes made between vocational training and vocational education. *Vocational training* means the specific preparation that will enable an individual to perform acceptably the requirements of a particular pay-roll job. *Vocational education* has a broader meaning. It includes the development of an understanding of the social and economic factors that relate to a job and that have influenced its development. The worker in modern industry is most likely to succeed if his preparation is not limited to specific skill training but includes a background of understanding that is provided by a real program of vocational education.

How Can Income Be Used to the Best Advantage? Earning an income is, of course, the first step in getting the goods we want. But the second step—using income to the best advantage—is about as important.

The problems that relate to the wise use of income are those that are involved in the economical use of money. Using one's money economically, however, does not imply stinginess or that one goes without the things he really needs. On the contrary, it implies the use of income in such a way as to derive the most satisfaction from its use, now and in the future.

Using one's money economically involves sound principles of business management. And the principles and processes of

income management are the same for an individual and for a family. The goals and the amounts of expenditures in the two cases may differ somewhat, but the underlying principles are the same.



What Are the Principles of Income Management? The needs of individuals and of families differ. For that reason it is impossible to lay down exact rules as to how much of the income should be spent and how much should be saved in any one case. Two individuals may have exactly the same amount of income, but it would be a mistake to assume that each should use his income in the same way. This is because the needs, the goals, and the responsibilities of people differ. For example, a young man with a certain amount of income and no dependents might reasonably spend a given amount for recreation and entertainment in the course of a year. Another young man with the same amount of income but with a dependent father and mother might find it impossible and undesirable to spend the same amount for these purposes.

Fundamentally, the essential elements involved in sound money management are: (1) the individual's or the family's goal in life; (2) a realistic estimation of income in the near future and in the more remote future; (3) apportioning of estimated income for different classes of expenditures; (4) getting reasonable value for the money that is spent; (5) keeping records and making adjustments of expenditures to current conditions so that they will conform to the long-term goal.

Budgeting. After an individual or a family has decided as to the goal in life, as it relates to financial matters, it is necessary to make rather definite plans for working toward that goal. This calls for making a budget. A *budget* is a statement of expected income and a plan for expenditures over a given period

of time. The period may be for a week, a month, a year, or for some other time.

Estimating the Amount of Income. The first step in making a budget is estimating the total amount of income that probably will be received for the period covered by the budget. Unless the individual or the family lives beyond his or its income, expenditures must be kept within the amount of income. The importance of doing this reminds us of something that the poet Goethe wrote, "He who does not stretch himself according to the coverlet finds his feet uncovered." And he who does not first determine the amount of his income before he plans his expenditures is very likely to find himself financially embarrassed.

In planning a family budget for a year, the amount of income from all sources should be tabulated. The dates at which the amounts are expected to be received should be indicated. For convenience such a record may be kept on a sheet of ruled paper, as in the following illustration:

The James B. Chandler Family
Estimated Income for 1945

Source of Income	Jan.	Feb.	Mar.	Apr.	May	June	Total
Services:							
Salary	200 —	200 —	200 —	200 —	200 —	200 —	2400 —
Savings and Investments:							
Interest	7 —						15 —
Miscellaneous:							
Total	207 —	200 —	200 —	200 —	200 —	200 —	2415 —

Estimate of Income

Planning Expenditures. After the amount of income for the year has been carefully and conservatively estimated, the next step is to decide just how the income will be used. It is at this point that budget making serves its most useful purpose. Although, as we observed above, it is not possible to say exactly

how much each person or family should spend for various items and classes of goods, it is well to consider in advance how much one can afford to spend. By doing so, individuals and families are much more likely to apportion their expenditures so that too much will not be spent for some classes of items and too little for others.

Although the figures may not apply to any one family in making up a budget, it is interesting and helpful to know the average expenditures of American families for various classes of goods. The following table is based upon a report of the National Resources Committee, which studied consumer expenditures in the United States for the year 1935-36.

AVERAGE EXPENDITURES OF AMERICAN FAMILIES IN CERTAIN INCOME GROUPS

Class of Expenditure	Average Expenditures			Percentage of Income		
	Lower Third	Middle Third	Upper Third	Lower Third	Middle Third	Upper Third
Food	$ 272	$ 445	$ 682	51.7	38.1	21.5
Shelter	204	378	789	38.9	32.4	24.9
Clothing	50	104	268	9.5	8.9	8.5
Transportation	30	86	275	5.6	7.4	8.7
Medical Care	27	49	114	5.1	4.2	3.6
Reading	5	12	23	.9	1.0	.7
Education	3	7	36	.6	.6	1.1
Recreation	9	26	89	1.7	2.2	2.8
Personal Care	12	24	49	2.3	2.1	1.5
Tobacco	13	24	41	2.5	2.1	1.3
Other Items	4	6	13	.8	.5	.4
All Items	$ 629	$1,161	$2,379	119.6	99.5	75.0

In the table the heading "Lower Third" refers to those families with incomes under $860 per year; the heading "Middle Third," to those with incomes of $860 to $1,560; the heading "Upper Third," to those with incomes of $1,560 and over. The following example will indicate how the table should be read: Families with incomes in the lower third spent, on an average, $272 per year for food. This expenditure represented 51.7 per cent of the annual income.

The table includes only expenditures for current consumption. If expenditures for gifts and personal taxes were included,

the totals of the percentage columns for both the Lower and Middle Third groups would exceed 100 per cent, indicating that help had been received in the form of government aid, charity, and gifts.

The following classification of family expenditures, which is adapted from one suggested by the United States Department of Agriculture, indicates the specific items that make up each classification. Note that "Housing," "Operating," and "Furnishings and Equipment" are used instead of the one classification "Shelter," which appears in the table on page 39.

CLASSIFICATION OF EXPENDITURES

(1) Food

(2) Housing
- Rent
- Taxes—property
- Fire insurance, etc.

(3) Operating
- Fuel
- Light and power
- Telephone
- Laundry done out
- Rent of safety-deposit box
- Fare on street car, etc.

(4) Furnishings and Equipment
- Furniture
- Bedding
- Stoves

(5) Clothing

(6) Health

(7) Developmental
- Formal education
- Reading matter
- Public welfare
- Recreation
- Vacation and trips
- Vocation

(8) Personal
- Candy, tobacco, beauty parlor
- Barber shop, cosmetics

(9) Automobile

(10) Savings
- Emergency fund
- Savings account
- Insurance, life
- Payments on house
- Investments

(11) Other Items
- Personal Taxes
- Gifts

In preparing a budget, it is important to remember that the amounts that will actually be spent for the various items can only be estimated. It is probable that expenditures for some items will be larger than the estimates, while in other cases they may be less. For example, one might plan to allow $75 for medical care, but because of serious illness he might find it necessary to spend a great deal more than that amount. Or one might change his mind about the amount to be spent for some other item. It should be recognized that a budget is expected to be flexible. It is merely a device for planning expenditures intelligently in advance.

The James B. Chandler Family
Budget for January, 1945

Estimated Income			Estimated Expenses		
Salary	200	—	Savings	20	—
Interest	7	—	Food	40	—
			Shelter	50	—
			Clothing	26	—
			Transportation	15	—
			Family Welfare	20	—
			Other Expenses	36	—
Total Income	207	—	Total Expenses	207	—

Family Budget

Engel's Laws. There are certain relationships that tend to exist between the size of personal and family incomes and the percentages that people spend for various classes of goods. This relationship has long been recognized. About the middle of the nineteenth century Ernst Engel, a Prussian statistician, made a study of the expenditures of the working classes in Europe. As a result of his study he arrived at some conclusions that are still often referred to as *Engel's laws.* These generalizations may be summarized as follows:

(1) As income increases, the relative amount spent for food decreases.

(2) The percentage spent for clothing remains about the same, regardless of the amount of income.

(3) The percentage spent for housing—including rent, light, fuel, and other similar items—remains more or less constant.

(4) As income increases, the relative amount used for miscellaneous purposes, including savings, increases.

More recent investigations tend to confirm the validity of Engel's conclusions.

Getting Your Money's Worth. How effectively one's income is used depends upon how wisely and skillfully he uses his money. It is not enough to decide that so much will be spent for food, so much for clothing, so much for shelter, and so much for other things. To a large extent the problem remains of deciding how much of each of the items in the different classes

of goods one will buy; when he will buy; where he will buy; and so on.

There are several rules that may be profitably observed in buying goods for consumptive purposes. The more important of these rules may be stated as follows:

Buy only those articles the use of which will produce the most satisfaction. For example, if the budget allows for only enough clothes to meet essential needs, it is foolish to spend a considerable part of one's money for freakish, specialized garments that have little practical use.

Buy at reputable establishments. Bargain hunting at "cheap" stores often results in a waste of money. While one may obtain an article in a cut-rate or bargain store at a price lower than in a more reputable store, the purchase may prove disappointing. Establishments of this kind sometimes depend upon the appeal of prices that appear to be low to attract customers, and not upon the quality of the merchandise they sell.

Buy at the right price and on the right terms. Where prices are not controlled by government or monopoly, we rely upon competition to cause merchants and others to sell at reasonable prices. Therefore, so long as the quality of goods is the same or similar, and the stores are practicing ethical business methods, one should not hesitate to buy where prices are lowest. Careless buyers encourage sellers to charge higher prices than are necessary to yield reasonable profits. And if one buys on terms other than cash, he should be careful to see that the terms are such as will enable him to meet them without undue hardship.

Learn to judge the quality of merchandise. How to acquire the ability to judge the quality of goods is not a matter that can be explained in a few simple words. The variety of consumption goods is so great and their composition and construction so complex in many instances that much observation, study, and experience are necessary before one can become an efficient buyer. But if one will observe the different kinds of merchandise, study the quality of goods, and endeavor to profit from his buying experiences, he will find that his income will go farther than it would if he did not carefully try to get his money's worth.

Keeping Records. Unless records of income and expenditures are kept, it is impossible to know whether income is the same as anticipated and whether it is being used in accordance with the budget plans. No one method of record keeping is best, but the system adopted should be one that will provide the needed information and one that is fairly simple. A cash record in the following form may be used:

The James B. Chandler Family

HOUSEHOLD INCOME AND EXPENSE RECORD

DATE		EXPLANATION	TOTALS: RECEIPTS	TOTALS: PAYMENTS	DISTRIBUTION OF SAVINGS AND EXPENSES: SAVINGS	FOOD	SHELTER	CLOTHING	TRANSPORTATION	FAMILY WELFARE	OTHER EXPENSES
1945											
Jan.	1	Balance	142 10								
	2	Rent		40 —			40 —				
	3	Dentist		3 —						3 —	
	3	Groceries		6 67		6 67					
	4	Dry Cleaning		2 25				2 25			
	4	Gasoline		2 —					2 —		
	5	Milk		5 65		5 65					
	6	Groceries and meat		8 43		8 43					
	7	Church offering		3 50							3 50
	29	Movie		1 20							1 20
	30	Shoes		7 73				7 73			
	31	Salary deductions	100 —	4 60							4 60
	31	Savings account		10 —	10 —						
			349 22	223 85	20 —	42 72	49 25	28 76	21 92	17 35	43 85
			349 22	223 85	20 —	42 72	49 25	28 76	21 92	17 35	43 85
	31	Balance		125 37							
			349 22	349 22							
Feb.	1	Balance	125 37								

Household Income and Expense Record

Preparing a Balance Sheet. At the end of each budget period, usually a calendar year, an individual or family should prepare a financial statement. In accounting language such a statement is called a *balance sheet*. It lists the *assets* of an individual or family (all items of property owned listed at their present values) and the *liabilities* (all debts). The difference between these two groups of items is the *present*, or *net, worth* of the individual or family.

By comparing the amount of net worth at the end of the period with that at the beginning of the period, the net increase or decrease in the wealth of the individual or family may easily be found. As you can see, there is a relationship between the record of income and expenditures on the one hand and the balance sheet on the other. The balance sheet reveals how much the net worth has changed, as well as what changes in assets and liabilities have occurred. The record of income and expenditures shows how the change in net worth on the balance sheet came about.

The James B. Chandler Family
Balance Sheet, December 31, 1945

Assets			Liabilities		
Cash	125	37	Dr. C. J. Wieland	25	—
Savings Account	385	16	Sheldon Finance Co.	150	—
U. S. Savings Bonds	500	—	Total Liabilities	175	—
Life Ins. Cash Value	635	—			
Social Security	204	75	Proprietorship		
Automobile	775	—	James B. Chandler		
Household Equipment	1395	50	Family Present Worth	3845	78
Total Assets	4020	78	Total Liab. and Prop.	4020	78

Family Balance Sheet

Before plans for the next budget period are made, the records kept for the preceding budget period should be studied carefully to determine what differences there were between the budget figures and those actually received as income or paid out as expenditures. This study may reveal that the budget figures need to be revised for the next period, or they may reveal that greater care should be exercised in the next period in the expenditure of income.

QUESTIONS ON THE CHAPTER

1. What is meant by the expression, "making a living means earning an income in the form of money"?
2. What are the two financial problems discussed in the chapter?
3. What are the four main sources of income?

4. Why is the selection of an occupation important?
5. Of what importance are the following in connection with the selection of an occupation: aptitudes; interests; vocational opportunities?
6. Is it possible for one to discover an occupation in which he is likely to be successful? If so, how can he do it? What distinction is sometimes made between vocational training and vocational education? Of what significance is this distinction to one who is planning for a particular occupation?
7. What is meant by "the economical use of money"?
8. What principles of money management are discussed in the chapter?
9. What is meant by "budgeting"?
10. Why is making an estimate of future income the first step in making up a budget? What suggestions are made in the chapter for estimating income?
11. Why is planning expenditures for the budget period important? What suggestions are made in the chapter for planning expenditures?
12. Why is it impossible to lay down definite rules as to the proper use of income?
13. Discuss the average expenditures of American families, as indicated by the report of the National Resources Committee.
14. What main classes of expenditures may be used in record keeping by an individual or family?
15. What suggestions are made in the chapter for buying economically and wisely? Which do you consider the most important?
16. Why is the keeping of records essential in connection with the carrying out of budget plans? What records are necessary?
17. What connection has a balance sheet with records showing income and expenditures?
18. What is the meaning of each of the following terms?

(a) **assets**
(b) **balance sheet**
(c) **budget**
(d) **Engel's Laws**
(e) **liabilities**
(f) **net worth**
(g) **vocational education**
(h) **vocational training**

APPLICATIONS OF THE CHAPTER

1. If you are to manage your own financial affairs systematically, what records will you need? In what respects would your records differ from those discussed and illustrated in this chapter?
2. Does your family operate on a budget? Have you discussed the subject of budgeting with your family? If so, what do

they think of it? (It is not necessary to discuss details of your family finances in class when you answer these questions.)

3. It may be possible for you to have an individual who is particularly interested in problems of personal or family money management speak to the class on this subject. If so, what points of information does the speaker develop that are not covered in the discussion in this chapter?
4. Obtain, if you can, a copy of the budget of your county, city, or state. Does it observe the principles of budgeting that are discussed in the chapter?
5. Report on a current article or a text that deals with vocational guidance. What are the most important points in the report?
6. What are some of the things that you can do in order to find out more definitely what kind of work you should select for your vocation? Be specific.

TOPICS FOR SPECIAL REPORTS

1. Prepare a typical budget for each of the following:
   (a) A boy or a girl who is a senior in school.
   (b) A young married couple with one child; income, $200 a month; they have recently purchased a home for $5,000, paying cash $1,500, the remainder to be paid in monthly installments over a period of 10 years. (Consult a building and loan association about how much the monthly payments will be.) They own an automobile. He carries $2,000 insurance, the premiums on which amount to $40 a year.
2. Report on the program of vocational guidance in your school.
3. Make a list of suggestions for getting your money's worth that are not given in the discussion of this chapter.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is ability to earn money more important than the ability to spend it wisely?
2. Should all the members of a family participate in making the budget?
3. Is a wife more responsible for the management and the use of family income than the husband?

CHAPTER 4

HELPS FOR THE CONSUMER

Dorothy Vernon is a stenographer in one of the downtown offices in her city. Because she is dependable, capable, and possesses a pleasing personality, she receives a very good salary. Like most young people who work, however, most of her pay check goes for food, rent, clothing, and amusements.

Dorothy is not dissatisfied with her salary or her work. Still, if she should discover that the amount of her check was incorrect, she would ask for an explanation. But when she spends her money, she is not equally careful to see that the articles she buys are worth what she pays for them.

Those of us who receive an income from work or other sources are usually careful to see that the amount is what it should be. But are we as careful to examine the quality, the kind, and the amounts of goods that we buy with the money? It is just as important that we obtain the right values for our money as it is that we receive the correct amount for our work.

Buying Goods Intelligently Is Difficult. Even when one gives a great deal of time to buying what he wants, selecting the best article for the money is difficult. Neither can we say that the buyer of goods always gets what he thinks he is buying at the time. For example, suppose you want some of the best toothpaste or powder you can buy. Since there are more than two hundred and fifty brands sold on the market, you can easily see that it would be impossible for you, from the standpoint of price, quality, and quantity, to decide exactly which is really the best brand.

Or suppose that you want to buy a cake of soap. The only real function of soap is to cleanse the skin without causing too much irritation. Any soap that will do this, does all that any soap can do, in spite of the fact that some advertisements may try to lead you to think that you can become more beautiful or a great social success if you will only use a certain kind of

soap. But which brand will you buy? Some soaps that are the least harmful are sold at reasonable prices. Other brands, which may be sold at a high price, may contain certain acids or other ingredients that are harmful to the skin. The odor has nothing to do with the cleansing qualities of a soap. As you can see, getting your money's worth when you buy may not be easy.

Perhaps the most important reason why intelligent buying is so difficult is the fact that the composition of most articles is unknown to the buyer. For example, it is impossible for the average person to tell by looking at it whether an article is pure silk or a composition of silk and rayon.

Carelessness is also a cause of much unintelligent buying. Even when people can find out more about the quality, quan-

Purchasing Groceries

As in the case of nearly all kinds of purchases, deciding just which of the various brands of canned goods is best is not easy.

U. S. Department of Agric

tity, and prices of an article, they often refuse to do so. Many times they continue to use a certain kind or brand from habit or because someone else uses it. We may continue to buy at a certain store just because we have done so for a long time or because some of our friends buy there. In some cases one may try to "keep up with the Joneses" by buying goods at stores that are known to cater to socially prominent people.

Salesmanship and Advertising Often Confuse the Buyer. Some kinds of advertising and salesmanship are helpful to consumers. When new and useful products appear on the market, advertising attracts attention to the goods. As a result, consumers are induced to try the products. If the articles are really useful and are sold at a reasonable price, advertising in such cases helps to raise the standard of living of the people.

Ever since men have associated with each other, it has been known that one person may influence and persuade another. Modern advertising has developed the art of persuasion to a high degree. Expert psychologists, who understand how to appeal to the wants of a great many people, are engaged to prepare advertising slogans and to advise as to the kind of photographs and pictures that will attract attention and influence buyers. Radio programs, sales talks, advertising copy of magazines and periodicals, and designs for posters and signs are skillfully prepared so as to direct attention and interest toward the product that is being advertised.

So long as advertising does not make use of false statements as to quality and quantity of the product and as to its effects on the user, we cannot condemn advertisers for their reasonable efforts to sell their goods. But unfortunately a great deal of advertising cannot be defended.

It Is Not Easy to Prevent Improper Advertising. It has always been regarded as the right of a person who has something to sell to "talk up" his merchandise. That is what advertising is intended to do, to set forth the good points of the article that is offered for sale. This does not mean that the seller should

be allowed to misrepresent his goods. But just what is misrepresentation? How can misrepresentation be proved?

If an automobile company states that "This is the world's best buy," it would be difficult to prove that the statement was not true, although many people might feel that it is an overstatement. So long as the seller merely expresses an opinion as to the quality and the value of his goods, he has, and he should have, a great deal of freedom in making his advertising claims. But when he makes a statement that is not true or one that expert and impartial opinion holds is not true, such advertising should be forbidden. For example, if a medical or a cosmetic preparation contains a drug that authorities say is harmful, the advertiser should not be allowed to tell the public that the preparation is harmless.

Would Grade Labeling Help the Consumer? Some people hold that the Government should adopt compulsory quality standards for all kinds of goods. For example, the standards for canned goods could be indicated as "Grade A," "Grade B," "Grade C," and "Substandard." Then the container would carry a label according to the grade of the contents.

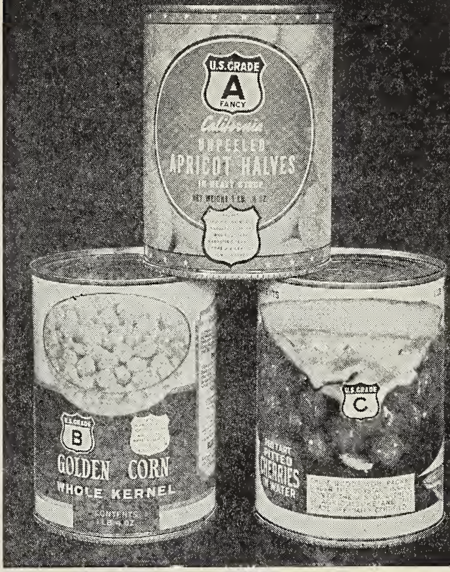
The Government has set up standards and requirements for labeling woolen goods. The label must show the proportion of wool used, the name of the manufacturer, and the kind of wool used. *Wool* means new wool that has never before been made up into woven or felted merchandise. *Reprocessed wool* refers to wool that has been woven or felted and then, without ever being used by the consumer, is reduced to a fibrous state and again made into some wool product. *Reworked wool* is wool that has been spun, woven, felted, or knitted and then, after being used by the consumer, is reduced to a fibrous state and again made into some wool product.

Many producers claim that it would be impossible to set up satisfactory grades for a number of kinds of goods. For example, they say that good coffee is the kind of coffee that one likes. Again, it has been asked, "How would you establish standards for women's hats?"

In spite of these objections, however, it is reasonable for consumers to demand that all products and articles be labeled

U. S. Grade Labels

Manufacturers using U. S. grade labels must provide for continuous inspection by the U. S. Department of Agriculture.



U. S. Department of Agriculture

in such a way as clearly to indicate their composition or contents. Such labeling would be informative and would differ from grade labeling. In a great many cases it would be possible to set up grades that would be indicative of quality.

Many Private Agencies Help the Consumer. The individual is badly handicapped in his efforts to make a wise decision in the selection of most of his purchases. But his own experiences with various articles and the experiences of his friends may be used to help him in many cases. For example, if he purchases a hat or a pair of shoes that do not give good service, he will probably select some other brand the next time he buys.

Private Research Organizations. There are a number of private independent organizations that offer services that are intended to help consumers. These organizations conduct experiments and analyses of certain classes of consumers' goods and issue reports as to their opinion of the quality and the values of the articles offered by different producers. For example, the various makes and kinds of soaps, radios, or automobiles may be examined and ranked under such headings as "High Quality," "Good Quality," "Not Acceptable," or some such titles. If it is not possible to buy and examine the articles in the laboratory, as would be the case with automobiles, the opinions of expert engineers who are not connected with any of the manufacturers are obtained, and recommendations are thus made on the basis of impartial opinion.

Two organizations of this kind are Consumers' Research, Incorporated, and Consumers' Union of the United States,

Incorporated. Consumers' Research was the first organization of its kind. It is a nonprofit organization. It does not accept financial support from manufacturers, merchants, advertising concerns, or any commercial organization. It keeps a staff of consultants and advisers, who test and report on a large number of items that are sold by competitive manufacturers. Members of the organization pay the annual fee and receive lists of recommended and not-recommended articles. The recommendations have often been criticized because it has been claimed that little attention is paid to style and that the only thing that counts in making recommendations is the material or physical features of an article. But in spite of some unfavorable criticism, the organization has grown rather rapidly since it was formed in 1930. In general, the Consumers' Union is organized for the same purposes and is conducted along the same lines.

Such organizations as these are handicapped by a lack of funds. The number of articles used by consumers is almost endless. Testing all the various articles on the market would be a great undertaking. It would require chemists, dietitians, engineers, and many other experts, besides much costly equipment. All these would call for more money than is available to these organizations.

Professional Organizations. The American Medical Association, which is composed of physicians and surgeons, has done much to expose quack patented medicines. "Elixers," "cancer cures," "health foods," many of which are either useless or positively harmful, have been called to the attention of the public. The association publishes a magazine, *Hygeia,* which often contains information concerning advertised preparations. This professional body issues a label of approval for foods that it has examined and approved. The label may be used by the manufacturers of approved products. In the field of dentistry, the American Dental Association also offers help by publishing a list of approved dental preparations.

Magazine Institutes. Some magazines maintain research departments for the purpose of examining products of companies that wish to place advertisements in the publications. These departments are often referred to as *magazine institutes.* The

institutes usually issue a seal that may be used by the companies whose products have been examined and approved. Many purchasers regard the seals of magazine institutes highly. Others assert that almost any manufacturer can get his product "approved" by a magazine institute, and for that reason approval does not mean much. It is sometimes said that the magazine institute is only a device to increase advertising.

Private Business Concerns. In our discussion of the methods that exist for the protection of consumers, we should not get the idea that business concerns do not attempt to help. Indeed, it is probable that business itself does more to help the consumer than does any other agency.

In the first place, reputable concerns, as a rule, intend to sell reliable merchandise. They know the value of satisfied customers. Proof of the intention of the better type of stores to deal honestly with their customers is the fact that goods that prove unsatisfactory may usually be returned.

Some of the largest stores maintain their own research departments. Here articles are tested before they are offered for sale. Goods that cannot meet the standards are not placed in stock. Companies that make their own tests of merchandise include some of the largest department and grocery-store organizations. Besides these, there are other private business concerns that make a special effort to see to it that honest merchandise is offered to consumers.

Trade Associations. A *trade association* is an organization of individuals and concerns engaged in similar kinds of business for the purpose of promoting the interests of all the members. Usually the objectives of trade associations include restricting competition among the members, regulating relations with employees, collecting credit information, gathering statistical information with respect to the products of the members, and co-operating in advertising. Some of the associations, however, have set up standards to which the merchandise offered by their members must conform. Such associations issue labels that may be placed on goods that meet the approval of the association. The National Hardwood Lumber Association has helped lumber producers to work out and to use standards for

grading lumber. The National Canners' Association has worked out a system for inspecting food that is placed in cans by manufacturing concerns that are members of the association. This association provides also for sanitary inspection of packing plants. These are some of the ways that trade associations have helped to protect consumers and to make retail buying easier.

Not all trade associations, however, give much attention to efforts intended to help the consumer. In fact, some trade associations have opposed the establishment of grading systems for consumer goods. But it is possible that business concerns, individually and through the efforts of their associations, will in the future give more thought to grading, inspection, labeling, and other matters that will enable people to buy goods more intelligently.

Better Business Bureaus. The National Better Business Bureau is supported by local Better Business Bureaus in many cities in the United States. The original purpose of the Better Business Bureau was to promote truth in advertising. Recently the bureaus have gone further. They have insisted that in some cases it is not enough for the local merchant to avoid misrepresentation in his advertising. They say that sometimes he should give information that will enable the public to judge the quality of the merchandise. For example, some bureaus have urged merchants who advertise imperfect hosiery to state that they are "seconds."

In the cities where there are Better Business Bureaus, a purchaser who buys goods that are not as represented in the advertisement may report the matter to the local bureau. If the advertiser is found guilty of misrepresentation, he is advised to stop using untruthful advertising. If he does not, he may be suspended from membership in the bureau. Usually a threat of suspension is sufficient to make a member discontinue a misleading advertisement. The local bureau also may take steps to control the unethical claims and actions of nonmember merchants.

Better Business Bureaus endeavor to check the efforts of those who would defraud or misguide consumers. They have sponsored radio talks, published advertisements, issued publications, and otherwise tried to give advice against fake invest-

ments and schemes for selling correspondence courses that have little value. The use of "bait" merchandise is discouraged. A *bait* is an attractive article that is placed in a window in order to induce customers to come into the store. When the customer enters a "baited" store, he probably finds that the store does not have the size of the article that he wants. The salesman then does his best to sell him another article at a higher price. Bureaus are opposed to the use of any kind of trick that may be used to persuade a person to buy. They hold that in the long run honesty in advertising and fair treatment of customers will result in greater profit to the merchants.

Government Helps the Consumer. When merchants and manufacturers charge high prices for certain articles, or when they sell goods that do not give satisfaction, we sometimes hear it said that the government should do something about it. Some people feel that there should be laws to control prices and to prevent producers from offering goods of poor quality. In other words, they think government should take a more active hand in protecting the consumer.

During the war, the Government established "ceiling" prices for most articles. There were some complaints, but most people were in favor of price control. Because goods were scarce and money more plentiful, prices would have skyrocketed if ceiling prices had not been adopted.

While all of us agree that the people, through government, should protect themselves against fraud and unjust prices, we have been unable to agree in all cases as to exactly what laws and regulations we should have. Nevertheless, we are trying to devise means by which government may render aid to consumers without destroying the principles and the practice of free enterprise. In trying to work out these means of helping consumers by the services of government, the general idea also is to leave individuals with as much freedom as possible in making their purchases.

Local and state governments, as well as the Federal Government, have laws and offer services for the aid of consumers.

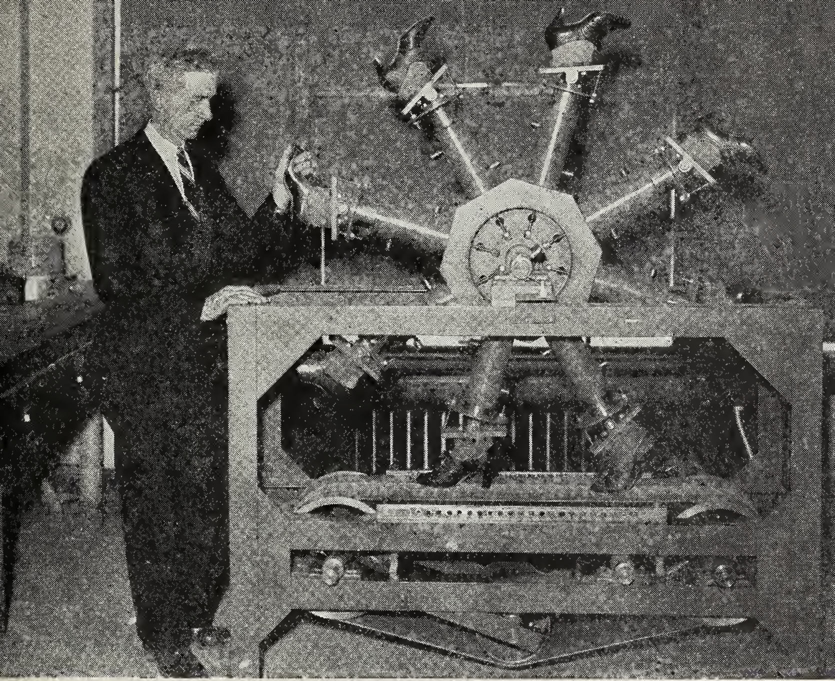
Aids Supplied by Local and State Governments. In some cases cities have laws that compel butchers to sell meats ac-

cording to the standards that have been set up by the United States Bureau of Agricultural Economics. In many cities there are also other laws for the regulation of the sale of merchandise, particularly of food. Regulations, however, vary from city to city, and in most cases the laws are not very rigid.

Some states have gone further than local governments in their efforts to protect consumers. Nearly three fourths of the states have laws that provide for the inspection of cold-storage warehouses. The object is to prevent the sale of partly spoiled, perishable foodstuffs, such as eggs, butter, meats, poultry, and fruits. In some cases retailers are compelled to give purchasers correct information concerning cold-storage articles. Some states have laws that compel the grading of apples, eggs, meat, gasoline and kerosene, and other products. As in the case of city laws, the state laws vary a great deal. Where laws exist for the regulation of the sale of products, they are not always enforced. Moreover, it is probable that in states that have such laws, a great many people are not even aware of the laws, or they know very little about them.

Aids Supplied by the Federal Government. Under our system of government, both the Federal and the state governments are limited to some extent as to what they can do to aid consumers. The Federal Government has little control over the production and the sale of goods wholly within a state. But it can make laws for the regulation of businesses that sell or transport goods in other states. Therefore, since most goods that are produced are sold in other states, the Federal Government has the power to pass laws regulating the production and the sale of most of the articles we use.

The Federal Government undertakes to protect and to help consumers in two ways. One way is by laws that must be obeyed by manufacturers and merchants engaged in interstate trade, and the other is by the distribution of information to consumers concerning standards of quality, fradulent advertising, and other matters. Many different government agencies are engaged in efforts to help consumers. Their efforts consist of research and education "ranging from the development of consumer grades to studies of food quality, price



National Bureau of Standards

Shoe Testing Machine

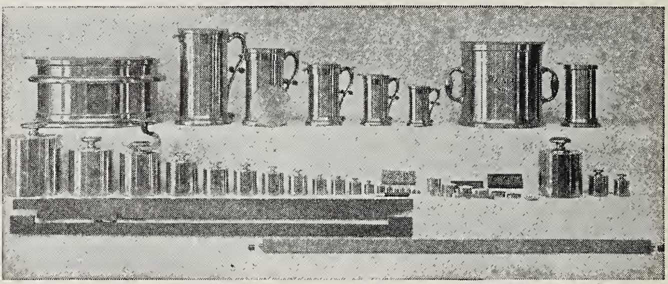
Manufacturers may have shoes and other products tested by the Bureau of Standards to determine qualities.

factors, the reasons for price changes, consumers' buying preferences, price spreads between producers and consumers, and the industries that make and distribute goods."

(1) *The Bureau of Standards* was established mainly to do research that would be useful to manufacturers and to carry on other types of scientific investigations. The Bureau of Standards tests goods and materials offered for sale to the Federal Government. State and local governments also may use the bureau for testing supplies that they are considering buying.

Indirectly the Bureau has helped consumers in two ways. It has helped manufacturers to standardize their products to a considerable degree, which standardization reduces manufacturing cost. Some of the saving is passed on to consumers in the way of lower-priced goods. Another way by which the Bureau aids in reducing the cost of production is by furnishing manu-

facturers with a list of manufacturers who have adopted the standards set up by the Government. In buying materials and supplies, the manufacturer who deals with producers who have adopted the standards of the Bureau knows the quality of what he is buying, which knowledge results in a saving to him. As in the case of savings from standardization of products, this helps to reduce the cost of production and the price the consumer has to pay.



National Bureau of Standards

Standards of Length, Mass, and Capacity

In the National Bureau of Standards at Washington are the original standards furnished to the states for measuring the size and the weight of goods and the capacity of containers.

(2) *The United States Public Health Service* renders services that protect health. It conducts inspections of oyster beds and packing plants and of food and water carried on trains and vessels operating between states. It also helps to safeguard health by attempting to prevent contagious diseases from entering the country and from being carried from one state to another.

(3) *The Post Office Department* is constantly on the watch for individuals and concerns who use the mails for the purpose of fraudulent advertising. Many get-rich-quick schemes and advertisements of useless or harmful goods have been stopped. Individuals who use the mails for fraudulent purposes, upon conviction, may be fined and imprisoned.

(4) *The Federal Trade Commission* can, under the law passed in 1938, bring suit against individuals and concerns for false advertising of food and drugs, where injury to health

may result from the use of the article. It can issue a cease and desist order to a producer or a merchant. This means that the sale of an article must be discontinued unless the producer or merchant goes before a court within sixty days and proves that he should be allowed to sell the article. In some cases the Commission can stop the sale of an article immediately.

(5) *The Food and Drug Administration*, under the law passed in 1938, attempts to prevent the adulteration and misbranding of foods and drugs that are shipped from one state to another. It collects and tests thousands of samples of goods and drugs of all kinds. Manufacturers and merchants who adulterate their products or use misleading labels may be prosecuted under the law by the Administration.

(6) *The Bureau of Home Economics* offers a number of leaflets and other publications that are of general value to consumers. For example, "Quality Guides in Buying" are a series of publications that give information and advice concerning the buying of various kinds of clothing and foods.

(7) *The Bureau of Agricultural Economics* performs many services that help consumers, as well as producers on farms. It has set up standards for grading butter, poultry, eggs, fresh fruits, fresh vegetables, veal, and dried and canned fruits and vegetables. Government inspectors visit stockyards where animals are brought for slaughtering. When diseased animals are discovered, they are immediately destroyed. All meat to be sold in another state must bear the stamp "U. S. Inspected and Passed." In addition, the Bureau performs other services that are intended to help and protect consumers.

Is More Consumer Protection Needed? Thus we see that there exist many agencies to help the consumer in getting the best values for his money. Some of these agencies, however, are very inadequate. In some cities and states practically no effort is made by government to restrain sellers from using almost any method they choose in getting the buyer's money. Where laws exist, they are often not enforced. And where efforts are being made to educate consumers and to supply them with needed information, the results are not so successful as they should be.

In spite of all the laws that can be passed and of any consumer education that may be offered in schools, the consumer will always find that he must be careful to exercise judgment in buying if he expects to use his money wisely.

Is the Consumer King? Under our economic system it is taken for granted that consumers know what they want and that they are willing to pay more for a good article than for a poor one. And, as we shall see later, the desire of people for goods is made known by market demand, that is, by the willingness and the ability of the people to buy different amounts of goods at different prices. Under our system it is taken for granted that goods will be produced if they can be sold at a profit.

Now, if the theory expressed above always worked out in practice, it would be correct to say that consumer demand would always control production. Producers would wait until consumers expressed their desire for a good by showing their willingness to pay for it. Then when they saw that there was a demand for the good, producers would begin producing it.

There is no doubt that manufacturers and other producers aim to produce only goods that the public will buy. But it is also true that manufacturers do not always wait for consumers to express a demand for their products. By means of salesmanship and advertising, producers often endeavor to create a demand for new products and to stimulate demand for goods and services already in use. For example, after the automobile was invented, a great deal of advertising was used to induce people to buy a "horseless carriage." Now that people are accustomed to using automobiles, manufacturers urge us to buy a latest model or even to buy two cars. Likewise, telephone companies insist that nearly every home needs an extension telephone. And makers of cosmetics help to create a demand for their goods by appealing to the desire of women for social approval.

American businessmen evidently believe that consumers can be greatly influenced in spending their money. Hundreds of millions of dollars are spent annually for advertising. In spending huge amounts for advertising, producers do not wait for

consumers to make up their minds as to what they want to buy; the producers are very busy trying to help the consumers to decide. We cannot say, therefore, that the consumer, alone and unaided, decides what shall be produced. While he cannot be compelled to buy any article of merchandise, manufacturers and merchants can "educate" people to want certain classes of goods and to buy certain articles by means of radio, newspaper, magazine, and other methods of advertising.

QUESTIONS ON THE CHAPTER

1. Why is it so difficult to buy intelligently?
2. What kinds of advertising and salesmanship are helpful to consumers?
3. Why do salesmanship and advertising often confuse the buyer?
4. What is the difference between proper and improper advertising?
5. To what extent would grade labeling help the consumer?
6. What are the private agencies that help the consumer?
7. What efforts have been made by Better Business Bureaus to protect the consumer?
8. What efforts have been made by the Federal Government to protect the consumer?
9. How do the following agencies affect your daily life as a consumer: Bureau of Standards; United States Public Health Service; Post Office Department; Federal Trade Commission; Food and Drug Administration; Bureau of Home Economics; Bureau of Agricultural Economics?
10. How may consumer demand control production?
11. How do advertisers create a demand for products?
12. What is the meaning of each of the following terms?

    (a) **bait**
    (b) **magazine institute**
    (c) **reprocessed wool**
    (d) **reworked wool**
    (e) **trade association**
    (f) **wool**

APPLICATIONS OF THE CHAPTER

1. What do your favorite brands of the following articles contain: toothpaste; chewing gum; candy bar; soup? Where did you get the information?
2. How can you judge cosmetics? Can you be certain that they contain nothing that might be injurious to health?
3. Is it possible for you to examine and test all the makes of any kind of article you buy? Why?

4. Make a list of the brands of the following articles: toothpaste, soaps, deodorants, shoes, automobiles, breakfast cereals, radios, or any other kind of article you prefer to consider. What are your difficulties in deciding which is the best value?
5. Make a list of the motives for buying each of the following: a pencil, a pair of shoes, a home, a box of candy, flowers, cosmetics, furniture, soap, an automobile, a radio, a tennis racquet. How do these motives relate to the qualities of materials, durability, and style of the articles?
6. Show how the size of one's income influences one's decisions as to what to buy.
7. It has been said that "goods are sold; they are not bought." What is implied by this statement?
8. "Consumer advertising appeals to the emotions." Do you agree? Give reasons for your answer.
9. Show how advertising may be a protection to the consumer.
10. Is advertising educational? Discuss.
11. Do you think advertising results in lower-priced goods? Why? Would as many goods be sold if there were no advertising?
12. What do you consider the one best method by which consumers can protect themselves from being imposed upon when buying goods?
13. Make an outline of a plan to aid the consumer. Is your plan practical? What problems might arise if you attempted to put it into practice?

TOPICS FOR SPECIAL REPORTS

1. The work of the Federal Food and Drug Administration.
2. Desirable and undesirable radio advertising.
3. How salespersons may aid the consumer.
4. How consumers may protect themselves in buying.
5. Advertising that is useful to consumers.

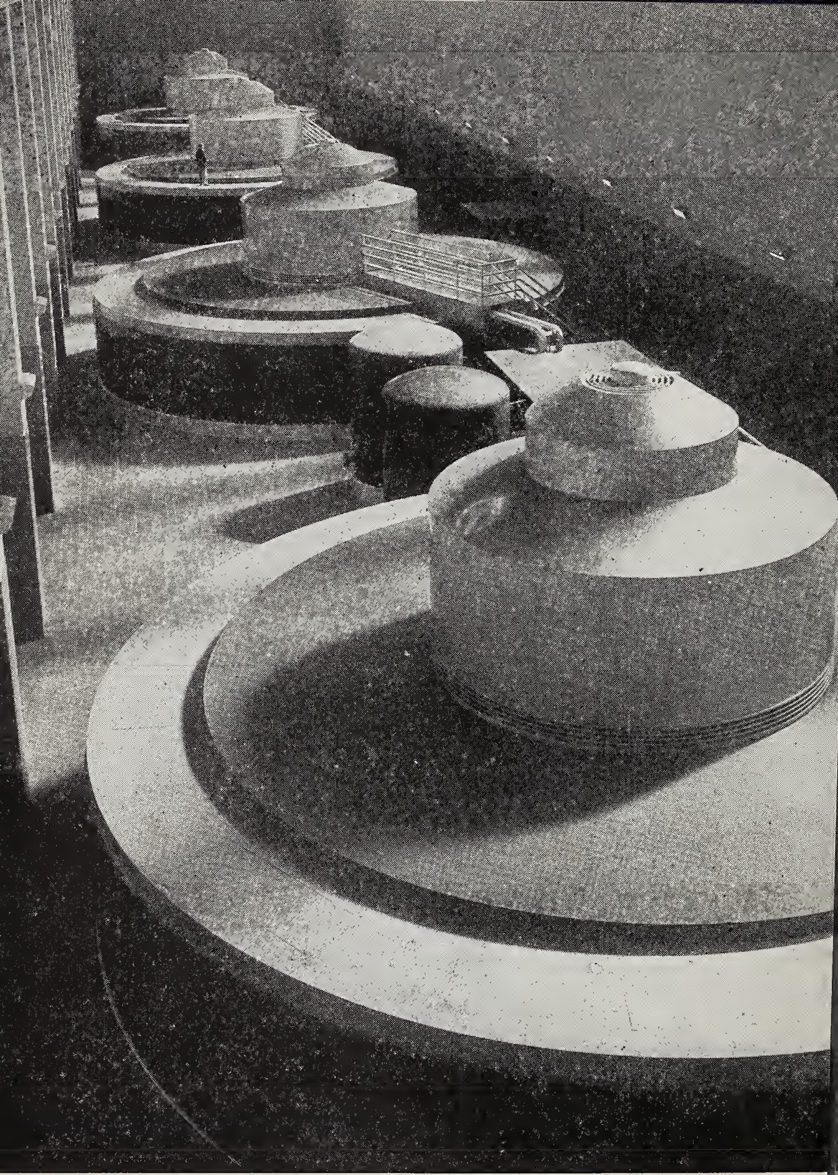
PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Does the Federal Food, Drug, and Cosmetic Act of 1938 give sufficient protection to the consumer?
2. Does free competition between manufacturers and merchants give ample protection to consumers?
3. Should government impose additional restrictions on advertising?

UNIT II

Wealth and Its Production

The nature of wealth, income, and production; and the organization of business for the production of wealth.



Wealth and Its Production
Generators in the Pickwick Landing Dam Powerhouse, TVA.

CHAPTER 5

WEALTH, INCOME, AND WELFARE

Whether rich or poor, most of the people in the United States feel that they are more fortunate than those in other countries. And millions of men and women have come here from other countries because of the opportunities offered. From 1820 to the present, more than 38,000,000 persons from other countries came to America. Laws have been passed limiting the number and the nationalities of immigrants that may be admitted each year. If it were not for those laws, there is little doubt that the number of foreigners who would come to the United States each year would be much larger than it is.

One of the reasons why most Americans are proud of their country, and the reason why so many people in other countries would like to come here, is that they feel that the opportunities for success are greater here than elsewhere. By "success" they probably mean the accumulation of wealth or money. Everyone, of course, would not agree that the accumulation of wealth or money should be the standard of success. But all would agree that a certain amount of wealth is necessary for comfort and happiness. And it is also true that in most civilized countries the people look upon the possession of wealth as one of the signs of success.

A certain amount of wealth is desirable because it may promote the well-being of those who have an opportunity to use it. In fact, many seem to believe that the more wealth one owns, the better off and happier he is. Therefore, because of the importance of wealth in the lives of people, it is desirable for us to understand exactly what is meant by the term.

Goods Satisfy Wants. Before we attempt to say just what wealth is, we should study the word "good" as it is used in economics. A *good* means anything that people desire. We usually think of a good as a material thing, as a pair of shoes, a loaf of

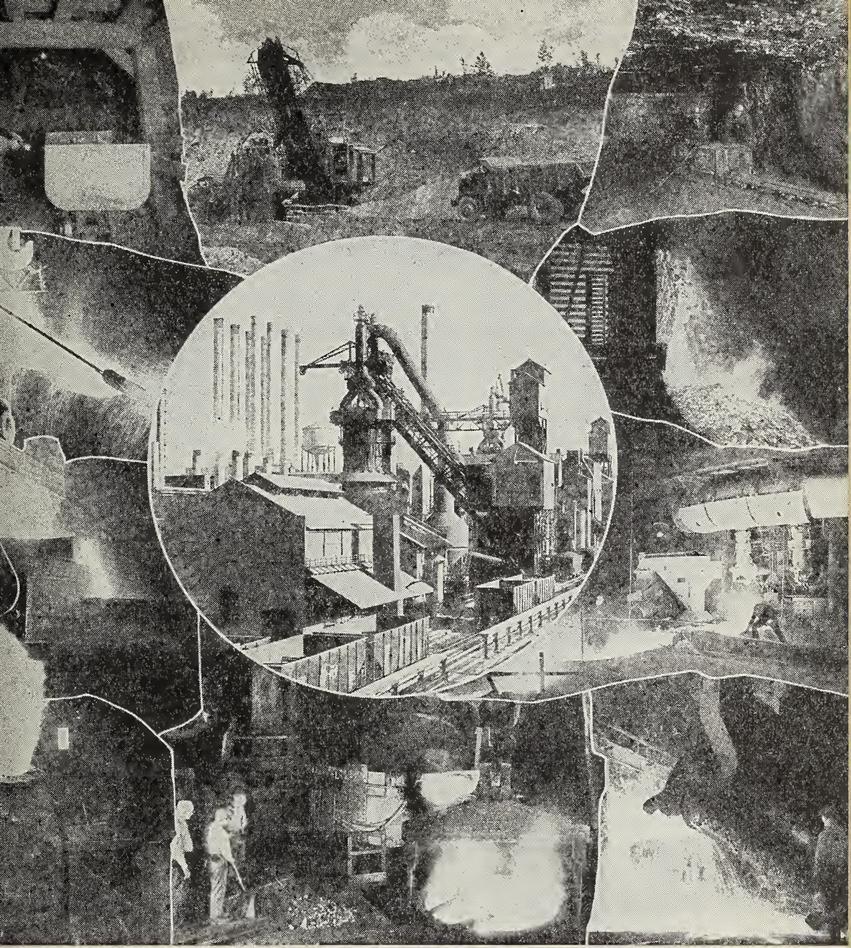
bread, or an automobile. The term, however, is used to include services, as the services of a workman or a physician. But whether we think of a good as being material or not, we desire it because we feel that it is capable of satisfying a want. The power or capacity of a good to satisfy a want is called its *utility.*

Free Goods. Some of the material things that we need and desire are supplied by nature in quantities sufficient for all who want them and in such a condition that they can be used just as they are. The supplies of air and of sunshine, for example, are sufficient in most places for everyone. Such things do not have to be changed in any way before using, nor do they cost any effort or money to obtain. For these reasons we call them *free goods.*

Economic Goods. On the other hand, some things, like iron ore or the timber in trees, must be changed in one or more ways before they can be used for most purposes. The quantity of nearly all material things is so limited we must use effort or money to obtain them. Therefore, we must economize in their use. For example, there are great deposits of coal in the United States, enough to last for hundreds of years at the rate at which coal is being used at the present time. But the coal has to be dug from the mine and carried to the place where it is wanted. Consequently, factories, families, and other users of coal have to pay for it. Therefore, in order to distinguish them from free goods, we say that any good that is limited in quantity and that costs effort or money to obtain is an *economic good.*

Free goods sometimes become economic goods. At one time in North America trees were so plentiful that no one would pay anything for a tree. And nearly everywhere air and sunshine were so plentiful that anyone could have all he wanted for nothing.

But as population increased, conditions changed. Now most of the land is owned by private individuals and business concerns, who have the right to prevent others from using it. In comparison with the population, land has become scarce. A great portion of the forests have been used up, so that trees for making good lumber are much scarcer than they were even a few years ago. As people have settled in towns and cities,



Ford Motor Company

Producing Economic Goods

Coal, iron ore, and limestone are made into iron and steel for the production of goods we want.

houses have been built close together. As a result, in the sections where the poorer people live, the amounts of sunshine and fresh air are limited. One of the reasons why the prices of building sites in certain parts of every city are higher than in others is that there is more sunshine and that the air is purer than in other localities.

There Are Two Classes of Economic Goods. Some economic goods are used directly in the satisfaction of our wants. Other economic goods satisfy our wants indirectly because they are used to produce things desired by consumers.

Consumers' Goods. Economic goods that are used directly in the satisfaction of our wants are called *consumers' goods.* Bread, meat, and clothing are examples of consumers' goods. Also houses used as residences and automobiles used for personal purposes are consumers' goods. Because some kinds of economic goods are used up quickly, they are often referred to as *nondurable consumers' goods;* while those that may be used over and over again for a considerable period of time are called *durable consumers' goods.*

Capital Goods. Machines, tools, factory buildings, and all things used for the production of other goods are *capital goods.* Capital goods also are sometimes classified into two groups. Those that are quickly used up, like coal that is used in a power plant, are designated as *circulating capital;* while those that last for a comparatively long time, such as machines and buildings, are called *fixed capital.*

Kinds of Economic Goods

- Consumers' goods
  - Nondurable consumers' goods
  - Durable consumers' goods
- Capital goods
  - Classified according to length of life
    - Circulating capital
    - Fixed capital
  - Classified according to uses
    - Free capital
    - Specialized capital

A Summary of the Kinds of Economic Goods

Another classification is sometimes made of capital goods. If a capital good is capable of being used for various purposes, as in the case of coal or gasoline, it is sometimes called *free capital.* If it can be used for only one or a very limited number of purposes, as is the case with a blast furnace or a cigarette-making machine, it may be referred to as *specialized capital.*

The importance of consumers' goods, of course, lies in their power to satisfy wants directly by their use. Capital goods are important because they make it possible to produce other goods in greater quantity and with less effort than would be possible otherwise.

Wealth Consists of Material Economic Goods. In the study of economics, it is desirable for us to say that *wealth* is anything that is material and is owned by someone, that has value, and that may be bought and sold. When owned by an individual or a private business, it is called *private wealth.* When owned by government, it is called *public wealth. National wealth* consists of all private and public wealth.

You understand now that wealth consists of a stock or supply of economic goods. Your wealth consists of your books, clothing, and other economic goods that you own. A farmer's wealth consists of his land, buildings, tools and equipment, livestock, grain, and perhaps other goods. The money he may have in the bank is not wealth as we have defined the term; it is merely the means by which he may obtain wealth. Likewise, a merchant's wealth may consist largely of goods and store equipment. His money enables him to obtain goods, which are wealth, when he wants them. As long as the money possesses value, it can be used to buy economic goods. But if it should become worthless—as did the money issued by the Confederate States—it could not be used for purchasing goods or services.

But all things that have value are not wealth. For example, a business concern may build up a good reputation for itself. Because of its good reputation people will buy more often from such a concern than from one that does not enjoy a good name. A good business reputation, which is often called *good will,* is worth a great deal to the owner of the business. If the owner wishes to sell his business, he can sometimes sell the good will

that he has established, for many of the old customers will likely continue to patronize the place.

Money has value also. But money, except metal money, is not an economic good. It is valuable only because it gives one the ability or power to obtain economic goods in exchange for it. Money is often used as a measure of the value of wealth. A man who owns a great deal of land, many buildings, livestock, or other kinds of property, if he does not also have a great amount of debt, is said to be wealthy. A man who has a million-dollar bank account, and no other kind of property, would be called wealthy. But his money in the bank is not wealth. It is only purchasing power.

Income Is Wealth Received or the Power To Obtain Wealth. By "power to obtain wealth" we usually mean money. *Personal income* is the amount of goods and services, or the right to goods and services, that one receives during a certain period of time. The value of the income is usually stated in terms of money; for example, $200 a month or $2,400 a year. And instead of receiving goods, income is usually received in the form of money, which gives one the power to obtain goods. But just as money is not wealth, so it is not real income, except to the extent that it gives one the ability to get goods and services.

In order to illustrate what is meant by *real personal income* and *money personal income*, suppose that Mr. Wilkes, a farmer, hires two farm workers, named Jones and Smith. He does not pay Jones any money at all. But he supplies him with food, clothing, a furnished room, a horse or an automobile when he takes a trip, and certain other things that are needed for his comfort and convenience. He also pays for any medical or dental services that Jones may need. Jones's monthly income, then, consists of goods and services that he receives.

Mr. Wilkes pays Smith $75 a month. With the money he receives, Smith must feed and clothe himself, provide his own quarters, pay for any medical services he may receive, and buy everything he uses.

Which one receives the more real income? That is to say, which of the two enjoys the use of the more goods and services?

Caterpillar Tractor Company

Farm Wealth

The wealth of this farm is used to produce income, which is a part of the national income.

The answer depends upon the prices of goods and services. If prices are very high, Smith may not be able to live so well as Jones. If prices are low enough, he can live better than Jones.

Personal income, then, consists of the goods or services that one receives within a period of time, say a day, a week, a month, or a year. Or it is the power or right to use goods or services one receives in the form of money or credit within a period of time.

The *annual national income* is the net amount of goods and services produced by the people of a country within a period of a year. It does not include those goods that are used to repair or to replace worn-out capital goods. The reason why goods used for these purposes are not included in the term is that they merely serve to maintain the productive equipment that was in use before. They do not increase the wealth of the nation or of individuals.

The national income consists of the products of factories, farms, mines, construction, and the services performed by government, merchants, banks, insurance companies, physicians, lawyers, personal-service workers, and others. Since it would be an endless task to try to list all the goods that are produced in a year's time, the amount of the national income is usually stated in terms of money. For example, it is said that in 1944 the national income was over $150,000,000,000.

Welfare Is Related to Wealth and Income. It is a good thing for a nation to accumulate wealth if the wealth promotes the welfare of the people. An increase in national wealth is less important when the wealth can be used by only a small portion of the people. Of course, this does not mean that everyone should have equal rights to the use of the wealth of the nation. But it does mean that the wealth should be used to promote the welfare of the people. Just how this can be brought about to the best advantage of all concerned is one of the hardest problems that confronts the world today. It is a problem the solution of which involves both economics and politics.

QUESTIONS ON THE CHAPTER

1. Why is the United States called the "land of opportunity"?
2. What is the real importance of wealth to a nation?
3. When does an object have economic utility?
4. Distinguish between a free good and an economic good.
5. What might cause a free good to become an economic good?
6. Distinguish between capital goods and consumers' goods. Give illustrations of each.
7. Consider a newspaper plant and give illustrations of fixed and circulating capital.
8. Give examples of public property that might be classified as fixed and circulating capital.
9. From your own home, give illustrations of durable and nondurable consumers' goods.
10. Of what value is good will to a merchant?
11. What constitutes the wealth of an individual? a corporation? a nation?
12. Distinguish between money income and real income.
13. What is the relation between personal income and national income?

14. What is the meaning of each of the following terms?

(a) **capital goods**
(b) **circulating capital**
(c) **consumers' goods**
(d) **durable consumers' goods**
(e) **economic good**
(f) **fixed capital**
(g) **free capital**
(h) **free goods**
(i) **good**
(j) **good will**
(k) **money personal income**
(l) **national income**
(m) **national wealth**
(n) **nondurable consumers' goods**
(o) **personal income**
(p) **private wealth**
(q) **public wealth**
(r) **real personal income**
(s) **specialized capital**
(t) **utility**
(u) **wealth**

APPLICATIONS OF THE CHAPTER

1. Why were such stringent immigration laws passed after 1920?
2. What did the poet mean in the following quotation?

   "Ill fares the land to hastening ills a prey
   Where wealth accumulates and men decay."

3. Can a nation be wealthy and the people be poor at the same time? Discuss.
4. How would a lack in capital goods affect the economic life of a people?
5. Give illustrations of goods that possess utility but that are dangerous to health and safety.
6. Mr. Ray owns an automobile that he uses for pleasure trips. He runs a store and uses a truck in making deliveries of goods. Is the automobile a consumer's good or a producer's good? Is the truck fixed or circulating capital?
7. Mr. Ashton owns a home, a store, an automobile, a dog, a riding horse, and some gardening tools; and he has $2,000 in the bank. Are all of these items wealth? Give reasons for your answer in each case.
8. What is meant by the following expression: "Income represents a flow of wealth over a period of time."
9. The Anderson's have a maid whom they pay $40 a month. They furnish her food, clothing, room, and pay her laundry expenses. What is the maid's income?
10. If you read that a Russian worker earned 600 rubles a year, would you have any idea as to his real income? Explain.
11. What thought in this chapter may be illustrated by the following quotation:

    Who steals my purse steals trash; . . . but he that filches from me my good name robs me of that which not enriches him, but leaves me poor indeed."

12. In 1929 nearly half of the families in the United States received less than $1,500 a year. Most of these families could have used twice that amount of income. Yet it has been said that the great business depression that began in that year was caused by overproduction. In the light of the discussion in the chapter do you agree? Give reasons for your answer.
13. Suppose the Government should print enough money to give every person as much as he now has and should send it to him on a certain day. Suppose you had $100, so that the Government would send you another $100. Could you then buy twice as much goods as you could before you received the extra money? Why?
14. During World War II why did the Government fix maximum, or "ceiling," prices and limit purchases of certain goods?
15. Would it be possible to divide equally the wealth of any country?
16. What problems may arise if too few people own too much of the nation's wealth?

TOPICS FOR SPECIAL REPORTS

1. Changes in the character of immigration to the United States from 1820 to 1920.
2. Changes in the national wealth and the national income since 1920.
3. Changes in the national income during the past ten years, including changes in the amount of the per capita income.
4. Things we value other than wealth.
5. Raising the standard of living of all the people.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is too much money invested in the production of capital goods?
2. Should America continue to be a land of refuge to the less fortunate in other countries?
3. Under our present order has everyone an opportunity to earn all the income that he needs?
4. Is money income an indication of success?

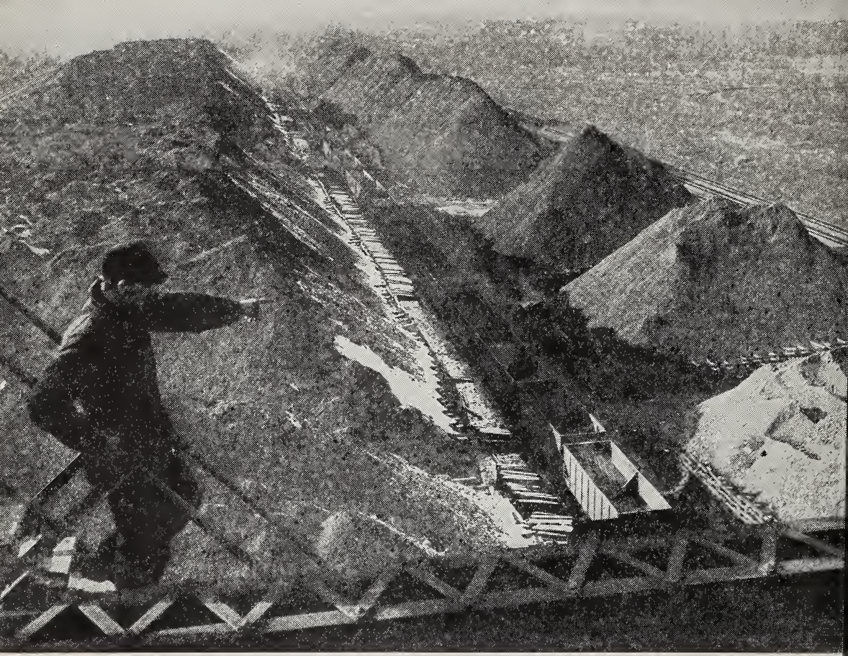
CHAPTER 6

PRODUCING THE THINGS WE WANT

A piece of iron ore looks like a fragment of red or brown rock. Nothing in its appearance reminds you of a suspension bridge, a typewriter, an automobile, or many of the various articles that are made from iron and steel. But when industry takes iron ore from the mine and forces it through the many processes that science has developed for making iron and steel, the ore takes on the many shapes and forms that make it one of the important bases of our civilization. Steel supplies the framework for our tall buildings, which are characteristic of American cities. It furnishes the tracks for the mile-long trains, which haul almost countless passengers and tons of freight over the quarter of a million miles of railroad lines in this country. It likewise supplies the material for the surgeon's keen knife and the delicate springs for even the smallest watches. In its natural state iron ore is not very valuable. But there is scarcely any limit to the number of things that can be made from it.

What is true of iron and steel is likewise true of nearly all the other kinds of material commodities we use. Nature supplies the raw materials, and by labor and the use of machinery we change the materials into new forms and shapes, which we call goods.

There Are Five Kinds of Utility. As we said in Chapter 5, the quality or capacity of a good to satisfy a want is called *utility*. It is because we believe that a good possesses utility that we desire it. For example, the reason you might desire an automobile would be that you thought the automobile had the capacity to satisfy your craving to go from place to place, to impress others, or to derive some other satisfaction from its use. We should be careful, however, not to think that utility and usefulness always mean the same thing. As a rule, we



Erie Rail

Elementary Utility

This iron ore will be smelted, processed into steel, rolled, and cut into many shapes until it becomes finished goods of many kinds.

think of a useful article as being one the use of which will promote the welfare of the user. But if one craves the use of tobacco, then tobacco possesses utility, although its use might possibly be harmful.

Before a good can satisfy a want, it must possess the following five kinds of utility:

(1) Elementary utility
(2) Form utility
(3) Place utility
(4) Time utility
(5) Possession utility

Elementary Utility. Every material thing in its natural state is made of certain elements. Because of the natural elements that compose trees of different kinds, the various kinds of ores, and other natural resources, it is possible to make these raw materials into many sorts of goods. These elements

Agricultural Adjustment Agency

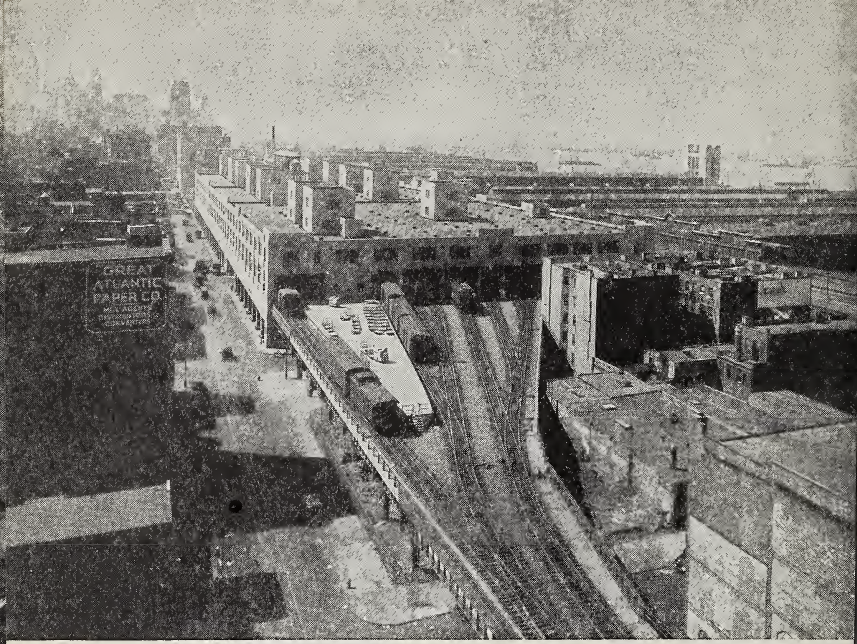
Form and Possession Utility

This farmer's tractor and plow have form and possession utility.

are substances such as gold, iron, lead, silver, and so on. Thus we may say that the utility that arises because of the elements of which a thing is composed is *elementary utility.*

Form Utility. Iron ore or coal as it is found in the mine is of little value because in that condition it cannot be used to satisfy our wants. The iron ore must be smelted by placing it in a blast furnace in order to remove the impurities before it can be made into articles of commerce. Coal must be broken into pieces before it can be used. These are examples that illustrate the need for changing natural resources into forms that make it possible for them to satisfy our needs. Changes in the shape or composition of materials that make the materials more usable result in the creation of form utility.

Therefore, the utility that an article possesses because of its form or the way it is made is called *form utility.* The primary purpose of industry, including agriculture, mining, lumbering, and manufacturing, is to create form utility.



New York Central

Place and Time Utility
Transportation agencies, freight terminals, and warehouses create place and time utilities.

Place Utility. After a good has acquired the desired form, it must be at the place where it is needed if it is to satisfy a want. For example, after automobiles have been manufactured, they must be distributed to the dealers and finally to the purchasers or consumers. Automobiles may be perfect and complete so far as form utility is concerned, but they cannot be used until they are at the place where they are wanted.

The capacity of a good to satisfy a want by being at the place where it is wanted is called *place utility.*

Time Utility. In addition to being at the place where it is needed, a good must be there at the time it is needed. Thus an automobile that exists now in a distant city but which cannot be delivered to you until next month cannot serve your need for transportation now.

The power of a good to satisfy a want because it is available when it is wanted is called *time utility.* One of the main functions of transportation companies and merchants is to create place and time utilities.

Possession Utility. If a box of fine chocolates were on your desk, but you were not permitted to taste them, the candy would do you little good. Therefore, as you see, if a good possesses only elementary, form, place, and time utilities, something is lacking. It must be possible for one to use a good before it can satisfy a want.

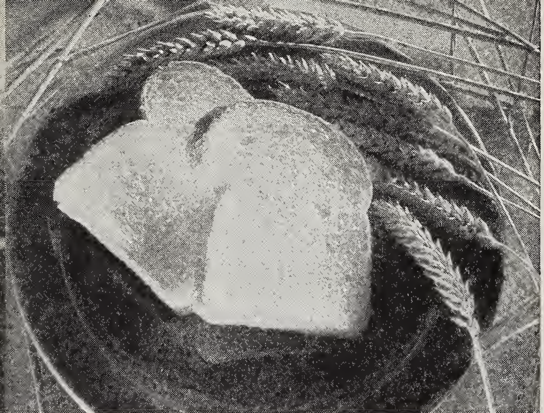
The utility that a good possesses because it is possible to use the good is called *possession* or *ownership utility.* Possession utility is usually created by purchase and sale. In this way one ordinarily acquires the possession and right to use articles. Occasionally one borrows an article, in which case the article has possession utility for the possessor. One of the important functions of merchants and all others who aid in the purchase and the sale of goods is to create possession utility.

The final selling price usually includes all the expenses incurred in giving a good all the forms of utility it possesses at the time.

Production Is the Creation of Utility. From the above discussion of utility we can understand the real nature of production. In everyday language, the term "production" usually suggests an activity that is intended to create form utility. But technically speaking, *production* is any act that results in the creation of utility of any kind. Therefore, everyone who assists in making goods available for use is a *producer,* because production is the creation of utility.

There are numerous business services that aid or facilitate production. These services include (1) the carrying on of communication, (2) the making of calculations of values and quantities, (3) the keeping of records, (4) the making of decisions and the managing of various phases of business and industry, (5) helping to supply money and credit, and (6) salesmanship and advertising. While the persons who perform these services may not be directly concerned with the creation of certain forms of utility, they perform services that aid production.

It often happens that when one kind of utility is created, another kind of utility also results at the same time. For example, it would seem that the shoe manufacturer is primarily concerned with the creation of form utility. But when he



U. S. Department of Agriculture

Production Is the Creation of Utility

Production creates utility by making slices of bread out of spikes of wheat.

makes a pair of shoes, he not only changes the form of leather and other materials, but makes the shoes available at a certain place at that time.

There Are Four Main Factors of Production. It is customary in the study of economics to speak of four main factors of production. These are: (1) land, (2) labor, (3) capital, and (4) entrepreneurship.

By the term *land* we mean all natural resources. Land, therefore, includes the soil, rocks, trees, rivers and oceans, ores of all kinds, and even the air and sunshine and other climatic factors. All of these are a gift of nature, and from them originate all of the goods that we use.

By *labor* we mean both physical and mental effort that is expended for the purpose of production. Labor includes the work of the bookkeeper, the stenographer, and the banker, as well as that of the mechanic and the farmer.

The economist often refers to producers' goods as *capital*, as we saw in Chapter 5. When used in this way, the term capital includes tools, machines, and all equipment that is used in producing other goods or in performing a service.

Entrepreneurship means the taking of business risk. The term "entrepreneur," which is of French origin, corresponds to our word *enterpriser*—the individual or individuals who assume the risk of a business enterprise.

Entrepreneurship, or business ownership, is an essential factor of production. The mere existence of the factors of land, labor, and capital, will not result in the production of goods. There must be some one or some group to decide what is to be

produced and to take the risk of failure. In the United States entrepreneurs are individuals, partners, and the owners of corporations, who are engaged in business for profit. The owner of a share in a corporation is a *stockholder* in the corporation; that is, he owns a part of the company. Individual ownership and partnership are often found in the case of small enterprises, such as grocery stores, barber shops, and farms. Large enterprises, like the General Electric Company or the Pennsylvania Railroad Company, are usually corporations, which are owned by individuals and other business concerns. But, of course, we must not imagine that all corporations are large concerns. Most corporations are relatively small.

In case the government engages in production, the taxpayers are the risk takers. To obtain the money or capital needed, the government borrows the money from the people and business concerns and then collects taxes from which the amount borrowed is repaid. Thus the taxpayers supply the capital and assume the risks of failure of the government enterprise.

Government Aids Production. The production of goods is not generally regarded as the primary function of government in this country. Yet we must not overlook the importance of government to private individuals and business concerns engaged in production. Besides preserving law and order, protecting property, and enforcing contracts, the local, state, and national governments aid business and industry in other ways. For example, the National Government collects statistics relating to the number and size, location, and output of business establishments. It also collects information from all parts of the world that aid in the sale of our goods in foreign countries. The Bureau of Standards performs experiments on manufacturing and building materials, helps to set up standards, many of which are useful to manufacturers, and performs other services that help producers. The Weather Bureau observes and reports on weather conditions, which is a valuable service to farmers and to those engaged in shipping goods. The Department of Agriculture maintains experimental centers for research in animal and plant breeding and for the discovery of methods for the prevention and the cure of animal and plant

diseases. To these we might add many other services that are furnished by government for the purpose of aiding production.

But government also directly engages in the production of goods and services, as in the case of the post-office system and the building and maintenance of public roads, streets, and the electric power and conservation services furnished by the Tennessee Valley Authority.

Much Production Is Indirect. If you and I should decide to make a living by farming, about the first thing we would do, after we had obtained some land, would be to buy some tools. And if we could not buy them, we would be compelled to set about making whatever tools we could. Or if we should decide to make shoes, we would either buy or make tools with which to work. In almost any kind of production we should find it very difficult to produce goods with our hands only. Tools and machines are made before goods for consumption are produced. Therefore, much of modern production is *indirect production.*

Tools enable a worker to do more and better work with a given amount of effort. Think how difficult it would be for a lumberman to fell a tree without a saw or an axe, or for a farmer to turn the soil without a plow. Or consider how impossible it would be to make a typewriter or a desk without tools of many kinds.

The *machine* is a device that makes use of one or more tools and that operates automatically. In most cases machines are driven by power in the form of steam or electricity. A carpenter's hammer is a tool, and so is a handsaw. But a device for operating a hammer or a band saw by steam or electricity is a machine. The advantage of the machine is that it operates tools automatically and with precision and that it is usually driven by mechanical power rather than by human effort. In most cases where it is possible to use a machine, production is easier, faster, more exact, and less tiresome than when tools are operated by hand.

Much of Modern Production Is on a Large Scale. Most of the articles we buy in stores were made in factories that produced thousands or even millions of articles of the same kind.

Owens-Illinois Glass Company

Mass Production

These newly fabricated bottles are ready for inspection and shipment.

Moreover, after the articles have been made, they are usually transported and sold to merchants in large quantities. The production of great numbers of the same kinds of articles in our modern factories is often referred to as *mass* or *large-scale production.*

The reason why large-scale production affects everyone is that goods produced in large quantities can be sold at a lower price than if only a few of each kind were made. Millions of dollars are required to build an automobile factory. Think what an automobile would have to sell for if only a few of each kind were produced. Or consider what the manufacturer would have to charge for the pencil that you can buy for 5 cents if he manufactured only a few pencils.

Large-scale production makes it worth while for the manufacturer to buy and use costly machinery. And since he uses

a great deal of materials, he can make use of the by-products. For example, in dressing the carcasses of the animals in the large meat-packing houses, bristles, hoofs, and other substances are removed. These substances are made into brushes, buttons, soap, lard, fertilizer, and other articles. Meat produced in the plant may be sold for less than it could be sold if the by-products were not utilized.

Large-scale production makes it possible to employ persons to perform special tasks. This is the reason for the division of labor that we can see in any large factory. And a division of labor enables a group of workers to turn out more products within a given time than if each one worked independently.

We must not conclude, however, that the unit cost of production always decreases as the volume of production increases. It is true in many cases that up to a certain point the cost of producing an article decreases as the number of articles turned out increases. But after that point is reached, the cost of each article increases if more are produced. The point at which there is the least cost in producing an article in any factory depends upon the proper balance or proportion between the amount of machinery and equipment, the amount of labor, power, and the ability of the managers of the establishment. It is possible for a business to become so big that it becomes less efficient than a smaller concern. If the managers are unable to keep all the factors in the best proportion, the cost of making an article in a large factory may be higher than in a smaller one.

Indirect Production Both Destroys and Creates Jobs. A few years ago in a certain small shoe factory more than three hundred workers were employed. Then new labor-saving machinery was installed, and nearly one third of the working force was discharged. In spite of this decrease in the laboring force, the factory was able to turn out more pairs of shoes each day than before.

The discharged workers, of course, were compelled to find employment elsewhere or to go without work. For some of them it was difficult to secure employment, even at lower wages than they had received in the shoe factory.

Unemployment caused by the introduction of labor-saving machinery—called *technological unemployment*—is an important problem in economic and social life. How it can be solved is a question. Some people have opposed the use of labor-saving devices. But if we should prevent the use of labor-saving tools and machinery, that would mean that we would refuse to use the most economical way of producing goods. From the standpoint of the people as a whole, it is desirable that all goods be produced at the lowest possible cost, which is to say, with the least amount of effort.

Perhaps all of us have a responsibility to those workers who are thrown out of work when new kinds of machinery are put into use. If employers install labor-saving machinery, they do so because they wish to reduce the cost of production and thus to make more profit. It would seem, therefore, that they owe something to any workers who are displaced from their work. Furthermore, since the use of machinery often means that all of us are able to obtain goods at lower costs, many feel that the public also should help those employees who are displaced from work to find new jobs or to train for a new kind of work.

Again, when a worker is displaced from one job by the installation of a new machine in a factory, he is not always discharged. In many cases he is given another place in the same factory, although the work may be different from that to which he has been accustomed.

In the long run, the use of more efficient machinery creates jobs. In the transportation industry the coming of the railroad caused a great decrease in the numbers of persons engaged in river and canal transportation. And the production of automobiles has done away with the need for nearly all wagon and carriage factories. On the other hand, there are a great many more persons employed in railroad transportation than were needed to operate river and canal boats when the railroad came. There are likewise a great many more workers in the automobile factories than were employed in the wagon and carriage factories thirty or forty years ago. Of course, part of this increase in the number of employees is due to an increase in population.

In addition, the automobile has created employment for thousands of filling-station operators, owners of and clerks in automobile accessory stores, and workers in factories that make parts for automobiles. And we should not overlook the fact that the demand for millions of tons of rubber, cotton, iron ore, leather, copper, and other materials used in making automobiles has also resulted in creating work for a greater number of persons in many industries, other than those in the factories where automobiles are assembled.

American Productive Efficiency Is High. The American factory worker turns out more goods per worker than do the workers in other industrial nations. It has been estimated that from 1935 to 1937 the physical output per factory worker in the United States in consumption goods was 84 per cent higher than that of an English worker, and higher than that when compared with German workers. In the production of capital goods and mineral products, the product of the American worker was nearly two and one-half times that of similar English workers, and more than twice that of German workers.

There are several reasons that explain the superior productiveness of the American factory worker. We have here an abundance of more kinds of raw materials, and there are relatively few trade barriers between the different parts of the country. This makes possible a large market, which, in turn, makes it worth while to produce goods on a large scale. Our manufacturers use a great deal of labor-saving machinery, much more per worker than do most manufacturers in other countries. Large numbers of the managers of the different phases of production are experienced men, who are accustomed to doing things "in a big way."

QUESTIONS ON THE CHAPTER

1. How does the utility of a good differ from its usefulness?
2. What kind of utility is produced by (a) a farmer? (b) a truck driver? (c) a coal miner? (d) a worker in a silk mill? (e) a cigar maker? (f) a merchant?
3. What are the four main factors in production?
4. In what ways do business services aid production?

5. What factor of production does each of the following examples represent?
   (a) coal
   (b) an individual's skill as a typist
   (c) a hammer
   (d) the sole owner of a drugstore
   (e) the service of a physician
   (f) a delivery truck
   (g) a vacant lot in the business district
   (h) a partner in a law office
   (i) a corporation stockholder
   (j) a factory building
6. What services does the Government furnish that aid production?
7. To what extent does Government engage directly in production?
8. What is the difference between a machine and a tool?
9. To what extent are we all responsible for technological unemployment?
10. How has specialization in industry created opportunities for young people?
11. Why is American productive efficiency high?
12. What is the meaning of each of the following terms?
    (a) **capital**
    (b) **elementary utility**
    (c) **enterpriser**
    (d) **entrepreneurship**
    (e) **form utility**
    (f) **indirect production**
    (g) **labor**
    (h) **land**
    (i) **large-scale production**
    (j) **machine**
    (k) **place utility**
    (l) **possession utility**
    (m) **producer**
    (n) **production**
    (o) **stockholder**
    (p) **technological unemployment**
    (q) **time utility**
    (r) **utility**

APPLICATIONS OF THE CHAPTER

1. How does a grove of oak trees differ in elementary utility from a grove of pine trees?
2. Why is an advertiser a producer?
3. How does thrift influence production?
4. Make a list of producers in your community who are engaged in producing different kinds of utility.
5. From the standpoint of production, discuss the importance of the contribution of each of the following: (a) a housewife; (b) a teacher; (c) an actor; (d) a novelist; (e) a coal miner; (f) a city official; (g) a farmer; (h) a man of leisure; (i) a physician.
6. From your community give examples of direct and indirect production.

7. Why is production in the United States affected by a war in Europe?
8. How much money has the Government spent upon the Tennessee Valley Authority? Was the project undertaken to produce goods or services?
9. Show how salesmanship is a facilitating service to aid production.
10. List five tools and five machines that you are likely to use in your daily life.
11. How have the changes that have occurred in transportation since 1900 affected your daily life?
12. From 1910 to 1940 the automobile changed considerably. Did these changes cause a great deal of waste in production? Explain.
13. Discuss the ways in which production in wheatgrowing has changed during the last one hundred years.
14. Explain what advantages follow from large-scale production.
15. Who controls production? What influence do consumers have on production? In what ways would full governmental control of production in this country differ from the present form of control?

TOPICS FOR SPECIAL REPORTS

1. The relative amounts of investments needed in the production of capital goods and in the production of consumers' goods.
2. The part Henry Ford has played in production in the United States.
3. Specialization in the making of a suit of clothes.
4. The danger of technological development.
5. The work of the United States Bureau of Standards.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Does specialization in industry tend to destroy initiative in labor?
2. Should government be considered a fifth factor of production?
3. Was the depression of 1929 caused by overproduction?
4. Should all production in the United States be planned?

CHAPTER 7

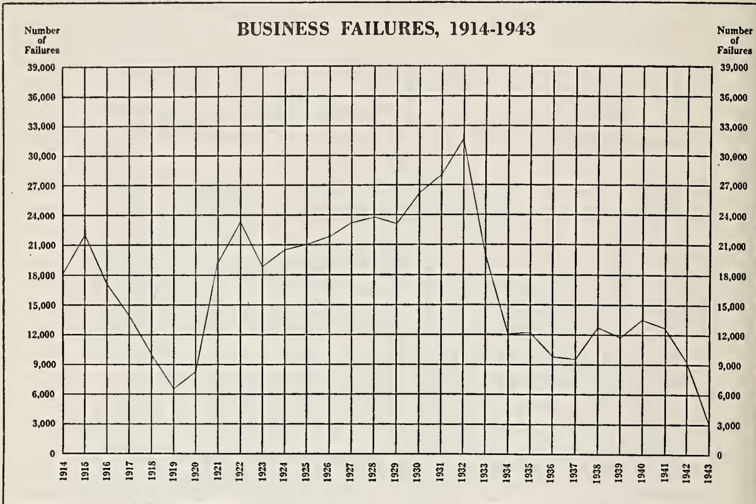
OWNING AND MANAGING BUSINESS

A few years ago in a certain Midwestern city there were four young men who held very good positions. William Anderson was a buyer in a department store. James Freeman held a responsible position with a wholesale concern. Ford Walker was the manager of a small hotel. Harold Weiss was employed by an accounting firm. Their salaries were large enough to enable them to save a considerable amount each year. Fortunately, each of them had inherited some money from relatives.

But they were ambitious to own businesses of their own. They had known each other since boyhood, and they frequently talked together of the advantages of being one's own "boss." At about the same time, each resigned his position and set up in business for himself. They launched their new enterprises with great enthusiasm and expectations.

Making a success in business, however, was not so easy as they had imagined it would be. By the end of twelve months Walker and Freeman had lost so much of their investments that they had closed their shops. About a year later, Weiss found that he, too, was losing money. Therefore, when the accounting firm offered him his former position, he accepted the offer and sold his business establishment to his brother. Of the four, Anderson alone remained in business.

The Owner's Risks of Failure Are Great. The experience of these four men may not be typical of all those who go into business for themselves. But it is a well-known fact that the risks of failure are great. Various estimates have been made as to the percentage of failure among those who set up in business on their own account. These estimates vary. But it is generally agreed that eventually a majority fail. On the whole, therefore, it would appear that the average person who undertakes to operate his own business has less than a fifty-fifty chance for success.



Number of Business Failures, 1914-1943

Note that during the years of the two world wars the number of failures decreased sharply. This was due largely to rising prices, which resulted generally in increased profits.

There are many things that may cause a business to fail. A list of the causes of business failures would include lack of a demand, poor location, changes in prices, physical disasters—such as fires, floods, and wars—lack of capital, and a lack of judgment and business ability on the part of the managers. As you can see, some of the risks of business are related to personal qualifications of the managers, while some are related to matters over which the manager may have no control.

The manager of a business may eliminate some of his risks by using good judgment and by carrying insurance. In spite of all he can do, however, there are always many chances for losing a part or all of his investment.

Owners May Manage Their Businesses. If you should invest your money in a store, you would expect to have the

right to decide how the store should be run. So long as you conducted the business according to law, you would have the final word as to how and when goods should be bought and sold and as to all other matters relating to the management of the business.

Ownership carries with it the right of management. If the owner finds that the business is too large for him to manage alone, he may employ others to help him. Or he may prefer to hire someone to run the business entirely, while he does something else. In the case of large corporations the owners are the shareholders. They meet—usually once a year—to elect a board of directors, who, in turn, appoint officials to manage the business.

There Are Several Kinds of Business Ownership. When the four factors of production—land, labor, capital, and ownership—are brought together for the purpose of production, the result is a *business unit.* The forms of ownership of business units most commonly found are: (1) single proprietorship, (2) partnership, (3) business corporation, (4) co-operative society, and (5) government.

A business that is owned by one individual is a *single proprietorship.* In a *partnership* two or more persons pool or combine their capital or services for the purpose of carrying on a business undertaking. A *corporation* is a business unit that is authorized by the state or the National Government and is controlled by private individuals. A *co-operative business society* or association resembles both a partnership and a corporation in certain respects. A *government enterprise* is a business unit that is owned by government.

In early times the manufacture and the sale of goods were conducted on a much smaller scale than they are at present. For that reason large amounts of capital were not necessary for the organization and the operation of most business enterprises. But as industry and business grew, more capital was needed, and the single proprietorship was often unable to meet the requirements for a satisfactory form of business organization. As a result, the other forms of business organizations that we have mentioned above came into existence.

Single Proprietorships Are Important. The number of single proprietorships in this country exceeds that of all other types of ownership. In some lines of business enterprise, production is carried on largely by single proprietors. This type of organization seems well adapted to certain kinds of businesses. This is noticeably true in farming. It is also largely true in the case of newsstands, fruit stands, candy stores, barber shops, beauty parlors, ice-cream parlors, and other businesses that do not require large investments of capital. Many doctors, lawyers, and other professional workers also operate their businesses as single proprietorships.

In many lines of manufacturing the sole proprietor plays a relatively small part. It has been estimated that single proprietorships and partnerships together manufacture less than one fifth of all the goods made in the country.

It has been claimed that in some lines of merchandising the small, one-man organization is being supplanted by the corporation. For example, in some cases chain stores, which are owned by large corporations, have apparently driven certain small proprietors out of business. This does not mean necessarily that the chain stores have employed unfair tactics in their competition for trade. But partly because of the fact that these larger concerns are able to buy goods in large quantities, they can often afford to sell articles at lower prices than the small merchant, who is compelled to buy in smaller quantities and who often uses poor business methods. In many instances, too, the chain store is better situated and, as a rule, displays its merchandise more attractively. Since sales are usually made for cash, losses from bad debts are avoided. Finally, such stores are usually conducted at the minimum expense consistent with good business practices.

On the other hand, it would be a mistake to think that small, individually owned stores are decreasing in number. In fact, from 1929 to 1939 there was an increase of about 240,000 in the number of individually owned stores in the United States, while the number of units of chain stores decreased about 14,000 within the same time. In spite of the decrease in the number of chain stores, however, chain stores did a larger percentage of the total retail business in 1939 than in 1929.

U. S. Department of Agriculture

A Single Proprietorship

Farming is typically a single proprietorship business.

Single Proprietorship Has Certain Advantages. Under some conditions the single proprietorship type of business is the most desirable form of business organization.

The Ease of Formation and Management. It is comparatively easy to start a small business that will not require much capital. One may set up a fruit stand, a grocery store, or in some cases even a small manufacturing establishment with little preparation or capital. And after the business has been started, the owner and manager can give his personal attention to all details of buying and selling and to directing any employees he may have.

Because of the personal attention that it is possible for the owner to give to the management of the enterprise, he may prevent some waste of labor and materials, which could not be eliminated in a larger establishment. For example, he may keep a close watch over the way in which the employees spend their time.

The relations between the employer and his employees are personal and nearly always friendly. For this reason labor difficulties are infrequent in an establishment owned by one person.

The Pride of Ownership. The desire for success seems natural. When a person owns his own business, he can see the results of his labor and he can watch his business grow as he succeeds. This is a matter of great importance to many owners of small business units. There are some persons who would rather be the sole owner of an enterprise than a member of a partnership or the owner of stock in a corporation, even though their profits would be more if their capital were invested in some other kind of business enterprise.

The Receipt of All Profits. When profits are made, the sole owner of a business receives all of them because he has taken all of the risks in his business.

The Ease of Dissolution. If the owner of a single proprietorship desires to discontinue his business, he may do so without having to consult others. No other kind of business organization can be dissolved so easily.

Single Proprietorship Has Disadvantages. The advantages of the single proprietorship are offset in some measure by certain possible disadvantages.

The Liability of the Owner. As the single proprietor receives all the profits of the business, he likewise bears all the losses. He must accept the undesirable results as well as the desirable.

In addition to his responsibility for losses arising from the operation of his business, the single proprietor is also liable for all the debts of his concern. Any property that he may own aside from that in the business itself may be taken by law to satisfy the debts owed in connection with the business.

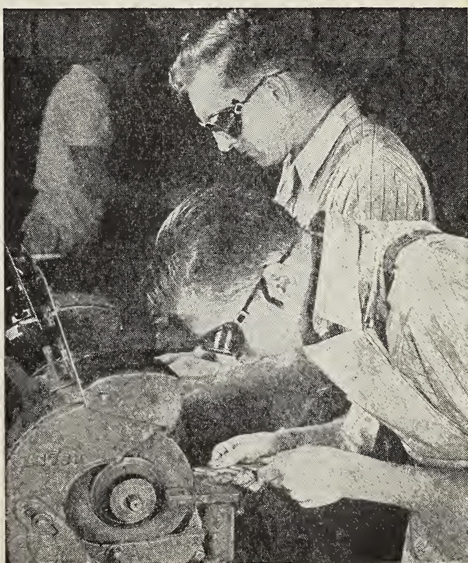
Limited Capital. The supply of capital in single proprietorship business is limited to what the proprietor owns and that which he can borrow upon his personal credit. There are comparatively few persons who possess enough capital to enable

them to carry on business on a large scale. Therefore few large business enterprises are owned as sole proprietorships.

The Limited Ability of One Person. The sole owner must usually rely upon his own judgment as to the policies and methods he follows. Of course, if he is financially able, he may employ experts to advise and to help him. But to the extent that he relies upon his own judgment, his ability to supervise and to direct his business is limited.

Many Businesses Are Conducted as Partnerships. The partnership form of business ownership is usually found in those instances where a comparatively small amount of capital is needed. Exclusive of the farming industry, there are about 300,000 partnerships of various forms in this country. This type of organization is found frequently in retail merchandising. Large merchandising establishments, however, are usually organized as corporations. Very often professional men, such as lawyers and doctors, use the partnership form. By grouping themselves together, they can sometimes reduce expenses and can economize in many ways.

There Are Different Kinds of Partnerships. Most partnerships are *general partnerships.* In such an organization each partner is liable for the debts of the firm, and the partners share the profits and the losses equally or according to some fixed ratio. For example, partners A, B, and C might agree to divide profits as follows: A, 40 per cent; B, 35 per cent; and C, 25 per cent.



At Work in a Small Factory

The partnership is frequently the form of ownership for small factories, stores, and professional businesses.

The laws of some states permit the formation of *limited partnerships*. In a limited partnership there are two classes of partners: *general partners,* those whose liability is unlimited, and *limited partners,* those whose liability is limited. In their dealings with creditors the members of a limited partnership must reveal the nature of the partnership. If they do not do so, they will be considered to be general partners.

Sometimes a person contributes capital to a partnership but does not take an active part in the management of the affairs of the firm. Such a person is a *silent partner*. He merely furnishes part of the capital and shares in the division of the profits or the losses. He is, however, equally liable for the debts of the concern.

In some cases an individual is willing to enter a partnership but for some reason does not wish his identity to become known. Such a partner is called a *secret partner*. He becomes liable for the debts of the partnership if his identity becomes known to the creditors.

The Partnership May Have Advantages. The partnership overcomes some of the disadvantages that are found in the single proprietorship.

Greater Capital. By combining their assets, two or more individuals can raise more capital than one of them could by acting alone. Moreover, there may be more security behind the loan, and in that case a bank will extend more credit to a partnership than to a one-man business.

Greater Efficiency. By combining their skill and judgment, two or more partners may be able to carry on a business more efficiently than either of them could alone. Thus, if one of them is a good salesman, he may give his time to the selling of goods, while each of the other partners may attend to those duties for which he is best adapted.

The Partnership May Also Possess Disadvantages. Most of the disadvantages found in the single proprietorship are present in the partnership, and there may be additional disadvantages.

Unlimited Liability. In the case of a general partnership each partner is individually liable for the debts of the firm. Ordinarily any partner may contract debts in connection with the business. Each of the partners is liable for the debts incurred by the others, as well as for those contracted by himself. To this extent, then, a partnership may result in a greater liability to one particular partner than would a single proprietorship.

The Danger of Disagreement. In a partnership, disagreements may arise as to the conduct of the business. Besides creating an unpleasant situation, disagreements may lead to the injury or the termination of the partnership.

The Difficulty of Transferring a Partnership Interest. No partner can sell his interest in the firm without the consent of all the other partners. Nor can another person succeed a partner upon the latter's death, except by the agreement of all concerned. The reason for these rules is that a partnership is an agreement between individuals and must be entered into willingly by each party.

The Division of Profits. It is sometimes said that the division of profits is a disadvantage of a partnership. This is a disadvantage, however, only in those cases in which one individual alone could supply the capital and the ability needed to carry on the business. If his share of the partnership profits would be larger than the amount he makes as a sole proprietor, so far as profits are concerned, it would be to his advantage to enter into a partnership business.

Partnership Agreements Should Be Written. All partnership agreements should be written. The dangers of misunderstandings and disagreements are so many and so great that the agreement should be drawn up in writing, signed by each partner, and witnessed by responsible individuals.

A partnership agreement is sometimes referred to as *articles of copartnership*. In general, the articles of copartnership should cover the following points:

1. The name and the purposes of the firm.
2. The names of the partners.

3. The kind and the amount of capital contributed by each partner.
4. The method of sharing the profits and the losses.
5. The duties and the responsibilities of each partner.
6. The length of time during which the partnership is to continue.
7. The method of dissolving the partnership.
8. Any other point upon which there should be a clear understanding.

QUESTIONS ON THE CHAPTER

1. Why do so many businesses fail?
2. What are the kinds of risk that the owner of business must face?
3. How can the owner of business avoid some risks?
4. What is "the right of management"?
5. Why is the ownership of capital necessary to production?
6. What are the different kinds of business organization?
7. Discuss the importance of the single proprietorship form of business organization.
8. What are the possible advantages of the single proprietorship?
9. What are the possible disadvantages of the single proprietorship?
10. Discuss the importance of partnerships.
11. What are the two most common forms of partnerships?
12. What are the advantages of the partnership over the single proprietorship?
13. What are the disadvantages of the partnership as compared with the single proprietorship?
14. What should the articles of copartnership include?
15. What is the meaning of each of the following terms?

    (a) **articles of copartnership**
    (b) **business unit**
    (c) **corporation**
    (d) **dissolution**
    (e) **general partner**
    (f) **general partnership**
    (g) **government enterprise**
    (h) **limited partner**
    (i) **limited partnership**
    (j) **partnership**
    (k) **secret partner**
    (l) **silent partner**
    (m) **single or sole proprietorship**

APPLICATIONS OF THE CHAPTER

1. What businesses do you know of that are owned by single proprietors? by partners? Discuss each from the standpoint of (a) size, (b) number of employees, (c) kinds of transactions carried on, and (d) other features.
2. Suppose that you wanted to enter into a partnership for the purpose of selling newspapers, of operating a grocery store, or of carrying on any kind of business that you may select. Write what you would consider a satisfactory agreement.
3. (a) Jones and Smith form a partnership for the purpose of selling shoes. Jones contributes fifteen thousand dollars, and Smith, five thousand dollars. Both men agree to give all their time to the business. Discuss the ways in which the profits may be divided.
   (b) Suppose that Smith contributes the amount indicated but prefers not to work in the store. How may the profits be divided?
4. Which of the advantages of the single proprietorship do you consider the most important? Why? Which of the disadvantages? Why?
5. Which of the advantages of the partnership do you consider the most important? Why? Which of the disadvantages? Why?
6. Discuss some of the misunderstandings that might arise in a partnership. Show how a written agreement might prevent such misunderstandings.
7. Under what conditions would you prefer to be a general partner? a silent partner? a secret partner? What would be the advantages and the disadvantages in each instance?
8. Two men are partners in a business. Both of them are honest. One of them owns a great deal of property aside from that in the business. The other, however, does not own much outside property. Besides, he is known to possess little business judgment. How will these facts affect the ability of the partners to obtain a loan from a bank?
9. Make a list of (a) the kinds of businesses that are better adapted to the single proprietorship, (b) those that are better adapted to the partnership type, and (c) those that are equally adapted to both kinds of organization. What factors determine the form of ownership to be used in a business?

TOPICS FOR SPECIAL REPORTS

1. Outline the duties of the owner of a single proprietorship with which you are familiar. What advantages and disadvantages

are encountered by reason of the fact that the business is owned by one individual? (The identity of the concern need not be revealed.)

2. Outline the duties of the partners of some partnership with which you are familiar. Give the advantages and the disadvantages of the partnership organization. (The identity of the firm need not be revealed.)
3. The qualities and characteristics of a successful business man or woman.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Do small businesses contribute more to the growth and the welfare of the community than do big concerns?
2. Is a partnership more likely to succeed than a single proprietorship?
3. Do owners of small businesses observe a higher standard of ethics in their dealings with customers than do the managers of larger businesses?

CHAPTER 8

BUSINESS CORPORATIONS

It is often said that this is the "age of big business." And for several reasons the statement is true. Many kinds of goods we use every day are made only in large factories. The railroads and many of the motor-truck lines and storage facilities that are employed in getting the goods to us are owned by corporations, the capital of which often amounts to many millions of dollars. Furthermore, huge concerns employ tens of thousands of workers. A large percentage of our employees depend upon big business corporations for jobs.

In the case of some kinds of goods, a comparatively small number of establishments are able to supply all the products sold on the market. For example, the great majority of all the automobiles manufactured in this country are made in factories controlled by three large companies, the Ford Motor Company, the General Motors Corporation, and the Chrysler Corporation. All of these concerns are corporations.

The business corporation as a type of ownership has made big business possible. Because large-scale business plays so important a part in our lives—whether we know it or not—we should know what a business corporation is and how it works.

A Corporation Is an Association of Individuals. The Supreme Court of the United States has defined a corporation as "an association of individuals united for some common purpose, and permitted to use a common name, and to change its members without dissolution of the association."

It is sometimes said that a corporation is a legal person, the life of which can be ended only by law or by the expiration of the charter under which it was formed. In general, the corporation enjoys many of the legal powers of a natural person, including the right to buy, receive, hold, and dispose of property; to enter into contracts; and to sue and to be sued.

The Corporation Has an Interesting History. The corporation as it exists today is of comparatively recent development, but its origin can be traced back through many centuries.

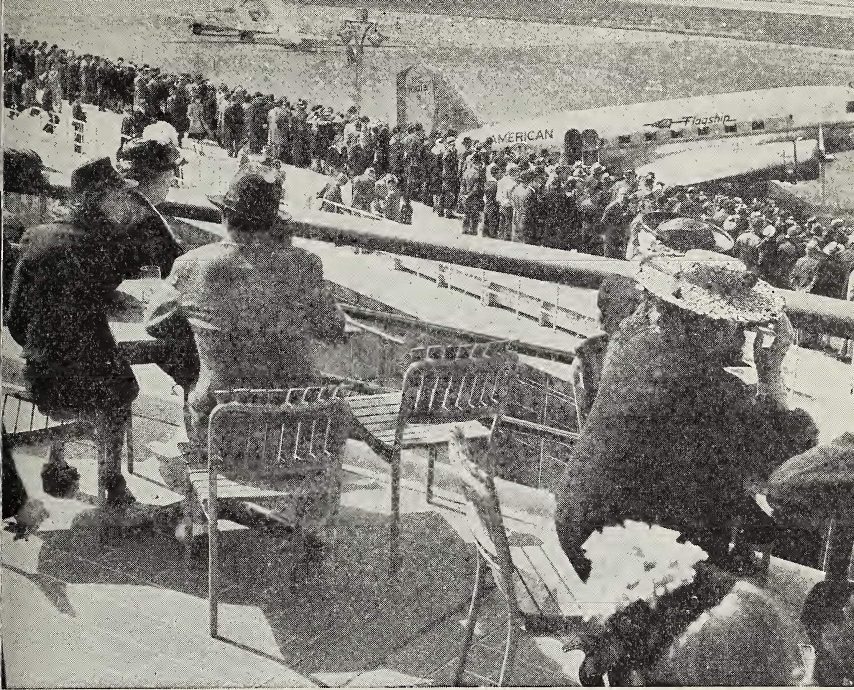
Early History. Early in the Middle Ages it became a common practice for religious persons to give to bishops and abbots endowments in the form of land, money, and other riches. Such endowments were not intended for the personal enjoyment of the clergy, but were to be held in trust for the purpose of helping those in need. For this reason it was desirable that the funds be placed with an owner that would continue to exist for generations and that would not be subject to death.

With ideas borrowed from the old Roman law, the medieval lawmakers worked out the plan of making the church an entity, separate and distinct from the individuals belonging to the church. In other words, the church and the religious organizations under its control were given a legal existence with the right to receive, hold, use, and dispose of property in the same manner as any natural person.

Modern Development. During the last three hundred years, as industry and trade increased, the need for permanence and continuity in the business unit became more and more pronounced. It was only natural, therefore, that the method of achieving permanence in religious organizations should be adopted for use in industry and trade. Kings and parliaments began to follow the practice of chartering companies, or "corporations," which were regarded in the eyes of the law as entities that possessed many of the legal rights and powers of a natural person. Some of these companies played an important part in the early history of this country. There were, for example, the Virginia Company, the Plymouth Company, the East India Company, and the Hudson Bay Company.

There Are Several Kinds of Corporations. There are different ways of classifying corporations. At this time, however, we shall consider all corporations as belonging to the following two groups:

1. *Public corporations,* which include the state, incorporated towns, and civil districts, such as the county.



American Airlines, Inc.

Scene at an Airport

Because of the large amount of capital and organization required, airlines are owned by corporations.

2. *Private corporations,* which may be classified as—
   a. *Nonprofit* or *eleemosynary corporations,* designed for social, charitable, and educational purposes. They include clubs, hospitals, colleges, and universities.
   b. *Business corporations,* that is, corporations organized for the purpose of making profits. They include organizations that operate stores, banks, and factories.

In this chapter we shall consider business corporations.

The Corporation Obtains a Charter from the Government. Formerly a corporation was created by the king or a legislative body. At the present time in this country each of the states has laws governing the formation of corporations. Although these laws vary somewhat, the typical procedure in the formation of a corporation is about as follows:

(1) A preliminary meeting is held by those who propose to form the corporation. The laws of each state provide that a minimum number of persons (usually three or five) is required to organize a corporation.

An application is then drawn up. This application usually includes:

The name of the corporation.
The purposes for which the corporation is to be formed.
The location of the home office.
The length of time for which the corporation is to be chartered.
The number of directors.
The names and the addresses of the members of the first board of directors.
The amount and the kinds of capital stock.
Any other items that are considered necessary.

The application is acknowledged, or sworn to, before a notary public. It is then sent, together with the necessary fees, to the secretary of the state in which the corporation is to be chartered.

(2) If the provisions of the application comply with the laws of the state, a *charter*, which contains the provisions set forth in the application, is granted. A duplicate copy of the charter is filed with the county clerk, or some other appropriate officer, in the county in which the home office is located.

Corporations Are Controlled by a Board of Directors. The corporation belongs to those who share in the ownership of the business. These persons are called *stockholders*. The charter gives the stockholders the right to elect a *board of directors*, who operate the corporation as they see fit, as long as their acts conform to law. The procedures to be followed in conducting the affairs of the corporation are set forth in a formal list of rules, called *by-laws*, which are drawn up by the incorporators or the board of directors. The by-laws prescribe the time and the place of each meeting of the stockholders, outline the powers and the duties of the directors, and set forth rules of action in regard to other matters.

The board of directors have the responsibility of supervising and controlling the affairs of the corporation. The management of the concern is in their hands. No stockholder, regardless of

Keystone View Co.

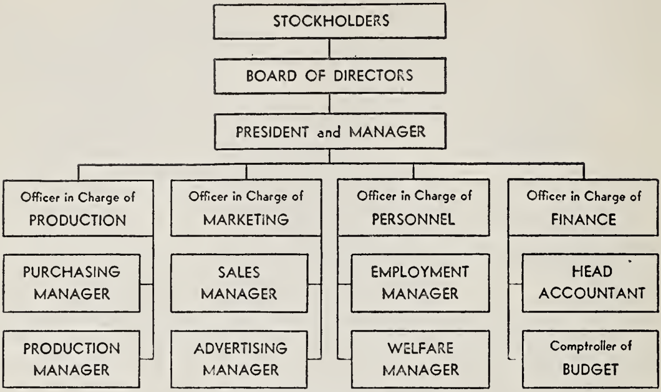
Meeting of a Board of Directors

The chairman and other members of the board of directors are studying plans and policies for the corporation that they control.

how much capital stock he may own, has the right to enter into any contract that will bind the corporation, unless he has been empowered to do so by the board of directors. The number of directors ranges from three to fifteen or twenty, and in a few cases it may be even more.

The directors do not personally attend to the operation of the business. They elect *officers* to whom they delegate the responsibility of carrying on the affairs of the corporation. These officers usually include a president, a vice-president, a secretary, a treasurer, and a manager. The directors are often also officers.

The responsibilities of the directors are great. If they exceed their authority, the state may cancel the charter. And if they cause the corporation to contract debts that are not authorized by the charter, they themselves become liable for payment.



Typical Organization of a Factory

The stockholders elect the board of directors, whose duties consist mainly of deciding the policies of the corporation, electing the officers, and deciding when to declare dividends. The president is the general executive officer.

Stockholders Share in the Profits of the Corporation. The disposition of the profits of a corporation rests with the board of directors. At stated times the board of directors meets in formal session and decides upon the division of the profits that have been earned. The profits to be distributed to the stockholders are called *dividends*. Dividends may be paid quarterly, that is, every three months, semiannually, or annually.

Usually the board of directors believes that some of the profits of each year should be retained in the business and should not be paid out in the form of dividends to the stockholders. The amount of profit retained is called *surplus.*

The Assets of a Corporation Are Owned by the Business. When a single proprietor puts ten thousand dollars into his own business, the money or other property thus invested still belongs to him. Likewise, if a person contributes that amount to a partnership, the assets belong to the partners. If the business is a single proprietorship, the owner may withdraw part of his investment at any time. By agreement with the other members of the firm, a partner may withdraw any or all of his investment from a partnership. Furthermore, the single

proprietor or the partners may sell the property of the business and thus may receive back part or all of their investments.

In the case of the corporation, however, money and other forms of capital contributed to the business become the property of the corporation. Hence the capital no longer belongs to the investors. In exchange for the amount contributed, the individual receives a *stock certificate*, which is a piece of paper certifying that the holder owns a certain number of shares of stock. The holder may sell or otherwise dispose of this certificate without consulting the corporation. A stockholder, however, cannot sell the property of the corporation; he can sell only the stock that he owns.

Capital Stock May Be Par-Value or Nopar-Value Stock. When a corporation is chartered, it is given the right to issue a definite number of shares of ownership called *stock*. All of this stock for a corporation is known as its *capital stock*. It is exchanged for money or other assets when it is sold to individuals and other business concerns.

Assume that the Richmond Manufacturing Company wishes to form a corporation with a capital stock of $1,000,000. The price at which the shares are to be sold can be determined by dividing the number of shares to be issued into the total amount of capital stock authorized by the charter. If the company wants to issue 10,000 shares, the value of each share will be $100; that is, 10,000 divided into $1,000,000. If it wants to issue 100,000 shares, the value of each share will be $10. In either case this value of each share, which is known as its *par value*, will be stated on the stock certificate, and the stock will be known as *par-value stock*.

In most states, however, the company may merely mention in its application for a charter the number of shares of stock that it proposes to issue. It will not have to specify a par value for each share or to mention the total money value of capital stock authorized. The company may then sell the stock at any price that can be obtained for it. Moreover, each stock certificate will specify that the holder owns a certain number of shares, but it will not mention the stated value of each share. In such a case the stock will be called *nopar-value stock*.

Formerly most stock was par-value stock. In recent years, however, the tendency has been to issue stock with no-par value. One of the reasons for nopar-value stock is that investors are less likely to be misled in the case of such stock than if the stock certificate has a stated value printed on it. If a stock certificate states, for example, that the par value is $100, a person may feel that each share will always be worth about $100. In reality, the value of the stock may be very much above or below that amount. Everyone who buys stock should know that the value of stock is determined largely by the present or by the estimated future earning power of the corporation and not by the price at which the stock was sold when it was issued.

Another reason for issuing nopar-value stock is that if par-value stock is sold below its par value, the buyer may later have to pay the amount of the discount to the corporation. But nopar-value stock may be sold at any price without making the buyer liable for any additional payment.

Stock May Also Be Classified as Common or Preferred. In order to appeal to different kinds of investors, corporations sometimes issue two or more kinds of stock.

Common Stock. If only one kind of stock is issued, it is known as *common stock.* The holder of a share of common stock is entitled to the following rights and privileges: (1) to vote in the election of the board of directors; (2) to receive a share of the profits, provided a dividend has been declared by the board of directors; (3) to share in the division of the assets if the corporation goes out of business; and (4) to sell or otherwise dispose of his stock. When a corporation has only common stock, all profits belong to the common stockholders.

Preferred Stock. When corporations issue two classes of capital stock, one of these is common stock, which was discussed above. The other is *preferred stock,* which entitles the holder to some kind of preference. The preference usually relates to the division of the profits or to the distribution of the money received from the sale of the assets in case of *liquidation* —that is, in case the corporation goes out of business and the assets are sold. As a rule, the charter of a corporation specifies

that the preferred stock does not give the holder the right to vote in the meetings of stockholders.

The holder of preferred stock is entitled to an amount of profit equal to a certain percentage of the par value of the stock. The percentage rate varies among corporations. The most usual rates are 5 to 7 per cent. A share of 7 per cent preferred stock with a par value of $100 entitles the holder to $7, if the board of directors declares an annual dividend.

To illustrate the preferential treatment usually given to preferred stock, let us assume that the Williams Milling Company has outstanding 1,000 shares of common stock and 1,000 shares of 7 per cent preferred stock, both stocks having a par value of $100. Suppose that profits of $16,000 are to be distributed to the stockholders in the form of dividends. The holders of the preferred stock will receive $7 on each share of stock held, or a total of $7,000, before the common stockholders receive anything. The common stockholders will therefore get $9,000, or $9 a share.

The preferred stockholders usually receive only a certain percentage of the par value of their stock and no more. If the stock has no par value, the rate of dividend is stated as a certain number of cents or dollars on each share.

Participating and Nonparticipating Preferred Stock. In some cases the preferred stock may share equally with the common stock in the profits remaining after both types of stockholders have received equal dividends. This is true unless the charter specifically limits the dividend to which the preferred stockholders are entitled. For example, if the profits to be divided in the case of the Williams Milling Company, referred to above, were $16,000, the preferred stockholders would receive $7,000, and then the common stockholders, $7,000. The remaining $2,000 would be divided equally between the two classes of stockholders. In most instances, however, the charter provides that the preferred stock will not participate in the division of the profits after it has received a stipulated amount.

Preferred stock that may participate in the division of the profits after having received a preferred amount of dividends is called *participating preferred stock.* If the stock cannot so participate, it is known as *nonparticipating preferred stock.*

Cumulative and Noncumulative Preferred Stock. Preferred stock is also classified as cumulative and noncumulative. But if the preferred stock is *cumulative*, all unpaid dividends must be paid before the common stock is entitled to any share of the profits. If the preferred stock is entitled to dividends only in the event that profits are earned during the year in which they are to be distributed, the stock is *noncumulative*. Obviously, cumulative preferred stock is the more desirable of the two as an investment.

Corporations May Borrow Money by Selling Bonds. In most cases the stockholders of a corporation do not supply all the capital needed by the concern. Some of it is furnished by those who sell goods to the corporation on credit. The obligations due such creditors are usually paid by the corporation within a few months.

Often, however, corporations need funds for a longer period of time. A factory, for example, might need several million dollars' worth of machinery and equipment or a new plant. In either case it usually would be difficult to repay the entire amount that is needed within a short time. It might therefore be desirable to obtain a loan for a number of years, possibly ten or fifteen years.

In order to obtain money for a long period of time, a corporation usually places a mortgage on part or all of the property owned, and then issues *bonds* to people who are willing to lend money to the corporation on the security offered by the mortgage. A bond is therefore essentially a long-time promissory note. If the loan is secured by a mortgage, it is a *mortgage bond*. If it is secured only by a general claim against the assets of the corporation, it is called a *debenture bond*.

Bonds bear interest at a fixed rate. The rate of interest varies usually from 2 to 6 per cent. Bond interest, unlike preferred-stock dividends, must be paid regardless of whether any profits are earned. If the corporation fails to pay the interest, the bondholders have the right to take over the management of the business. The bondholder is a creditor of the business and expects his loan to be repaid, whereas a stockholder is a part owner.

Gottscho-Schleisner

Entrance to the New York Stock Exchange
The stocks and bonds of many of the largest American corporations are bought and sold here.

Corporations Have Advantages and Disadvantages. From the preceding discussion it is apparent that the corporate form of business organization has both advantages and disadvantages. The following is a summary of the more important of the possible advantages and disadvantages.

Advantages. The advantages that the corporate form has over the partnership and the single proprietorship are:

(1) *Limited Liability.* We recall that in the case of a single proprietorship the capital of an enterprise is owned by one individual and that in the case of a partnership the ownership resides in two or more individuals. Any other property owned by the single proprietor or by any partner, except limited partners, may be taken to satisfy the debts of the business. The business itself does not, in the eyes of the law, exist separately and apart from the individual or individuals who own it.

As a rule, the liability of the stockholders in a corporation is limited to the amount of their investment. In the event of the bankruptcy of the business the creditors may ordinarily take all the property belonging to the corporation; but they cannot, in most cases, take property belonging personally to the stockholders. Suppose, for example, you own 10 shares of stock for which you paid $100 a share, or a total of $1,000. If the amount of the debts of the company should become larger than the total value of the assets, the creditors might force the sale of the assets and might keep the money realized from the sale. But no property that you own could be taken to satisfy the debts of the company, even though the money received from the sale of the company's assets was not sufficient to cover the claims of the creditors.

(2) *Continuous Existence.* When the owner of a single proprietorship dies, the ownership of the assets of the business passes to someone else. Likewise, when a partner dies, the ownership of his interest in the partnership changes, and a new firm has to be formed. In either case the ownership of the property in the business changes upon the death of the single proprietor or of any partner. Hence, it may be said that the life of a single proprietorship or a partnership is limited by the life of the person or persons who own it. The corporation, on the other hand, has continuous existence independent of the individuals or concerns that hold its stock. If a stockholder dies, his shares of stock become the property of his heirs or his estate.

(3) *Greater Capital.* The investment made by the owner in a single proprietorship is limited to his personal finances and to what he can borrow. Likewise, the investment of the relatively

few owners of a partnership is limited to the personal finances of the partners and their borrowing ability. In a corporation, however, a share of stock usually does not cost a great deal so that many persons with small savings can become part owners. Of course, those who wish to make large investments in the corporation simply buy a larger number of shares of stock. Furthermore, in a corporation a person who is not interested in taking an active part in the management of the business can invest his money in shares of stock and leave to others the details of management. For these reasons, a business organized as a corporation can often secure a large capital investment.

(4) *Easy Transfer of Investment.* When a sole proprietor wishes to change his business investment, the only way he can do so is to sell his entire business. When a partner wishes to transfer his interest in a partnership, he cannot do so without the consent of the other partners except by becoming legally liable for any damages they may suffer as a result of his act. If a partner does leave the business with or without the consent of the other partners, the partnership is dissolved and a new partnership is formed. The owner of one or more shares of stock in a corporation, however, may transfer part or all of his interest at any time without the consent of other stockholders.

Disadvantages. On the other hand, the corporation has certain disadvantages. Not all corporations, however, are handicapped by the same kinds or number of disadvantages. The disadvantages most frequently encountered are:

(1) *Limitation of credit.* A small business operated as a corporation may find it more difficult to obtain a loan from a bank than it would if it were a partnership. This difficulty is due to the limitation of the liability of the members for the debts of the concern.

(2) *Amount of governmental control.* The public as a whole does not have a great amount of sympathy for corporations. We shall not attempt to decide here whether this is due to indifference and lack of understanding on the part of the public or to the actions of corporations. At any rate, it is often com-

paratively easy for lawmakers to put through measures designed to control corporations in various ways.

(3) *High fees and taxes.* We have already seen that an incorporation fee must be paid at the time the application for a charter is filed. As a rule, a corporation pays higher state and Federal taxes than would a single proprietorship or a partnership operating on the same scale.

Corporations May Combine in Various Ways. From the time of the Industrial Revolution to the present there has been a tendency for business concerns to grow in size and power. During the last seventy-five years, however, the tendency has been more marked than before. The reasons have been (1) the desire for the greater economies that are often possible by means of large-scale production and (2) the desire for wealth and power on the part of shrewd and ambitious businessmen. In order to centralize control over large amounts of capital, various methods have been employed.

Pools. The earliest type of centralizing control of business for the purpose of increasing profits and discouraging competition was that of the pool. A *pool* is an agreement between competing concerns to co-operate in fixing prices and in establishing trade practices. Each company in the pool remains independent of the others, except with respect to the agreement to co-operate in certain ways. Sometimes a pool may be merely a "gentlemen's agreement," that is, a verbal understanding between the managers of the companies involved.

A pool may be an agreement to restrict production in order to prevent a fall in prices of the product manufactured or of the services rendered by the members of the pool. At one time express companies had pools by which they divided up among themselves the business of carrying express in certain parts of the country. Each company then shared in the distribution of profits according to agreement.

Trusts. Largely because the members of pools would not keep their promises, another type of control tended to replace the pool. This was the trust. The *trust* is an arrangement whereby the stockholders in competing corporations engaged in the

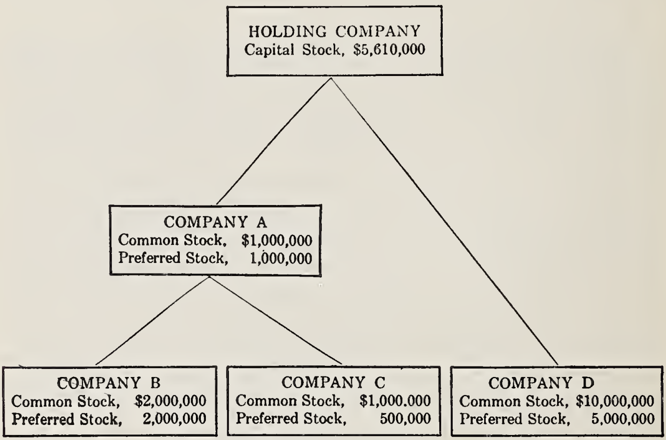
same kind of business give over their stock to a group of trustees and receive in exchange "trust certificates." The trustees can then run the corporations as they see fit. The holders of the trust certificates are entitled to part of the profits. If the trust is large enough, competition can be prevented and prices can be fixed as the managers of the trust desire. The first notable instance of a trust was that of the Standard Oil Company, which was formed by John D. Rockefeller and his associates in 1879. Because trusts became so powerful, public sentiment resulted in the passage of the Sherman Antitrust Act of 1890, which was intended to control business combinations. Under the law it became illegal for corporations to organize in the form of trusts.

Holding Companies. Outlawing trusts, however, did not prevent businessmen from finding other ways of centralizing management. One of these ways is the holding company. A *holding company* is a corporation that has been organized primarily for the purpose of buying and holding stock in other corporations. The companies whose stock is held by the holding company are called *subsidiary companies.* The object of the holding company is to control the policies and the operations of the corporations in which it holds stock. Some holding companies do no manufacturing or trading in goods; their only function is to hold the stock and control the affairs of operating concerns, those that actually manufacture or sell goods or services. There are also some operating companies that hold a controlling interest in other corporations. Such companies are sometimes also referred to as holding companies.

In some instances holding companies are able to effect economies and to stabilize certain branches of industry and business. A holding company may obtain a controlling interest in the stock of several competing companies and may thus cause the latter to adopt uniform prices or policies. Or a holding company may make it possible for a number of smaller concerns to centralize their purchases and thus be able to buy supplies, materials, and other goods more economically than they could if each of the companies made its purchases separately. Hence, the holding company sometimes is able to manage a

group of corporations so as to make larger profits for all the stockholders and to supply goods and services to the public at lower prices than would be the case without the holding company.

Sometimes one holding company is superimposed upon other holding companies in such a way that the control of large amounts of capital is placed in the hands of a few wealthy individuals. Since small stockholders seldom take any active part in the election of directors, these few large stockholders may control the election of the directors and the officers in both producing and holding companies. The practice of exercising control over producing companies by means of holding companies is sometimes referred to as *pyramiding control.*



How a Holding Company Operates

By means of stock ownership a holding company may control the policies and the activities of several companies. With a capital of $5,610,000, or 51 per cent of the common stock of Companies A and D, the holding company can control capital amounting to $22,500,000.

Large holding companies have sometimes been able to acquire a monopoly in certain kinds of business. When this has happened, they have frequently been accused of charging exorbitant prices, of defrauding stockholders in subsidiary companies, and of indulging in other undesirable practices. Several

Federal laws have been passed to curb the growth of holding companies. Among these laws are the Sherman Antitrust Act, the Clayton Antitrust Act, the Federal Trade Commission Act, and the Public Utility Holding Act of 1935. Most of the laws deal with other matters also. The enforcement of the Public Utility Holding Company Act is in the hands of the Securities Exchange Commission, which has the power to compel companies to supply complete financial information of their activities. In some cases the Commission may compel the holding company to dissolve.

Mergers and Consolidations. In the case of the holding company the subsidiary companies retain their own names. For example, such companies as General Motors and Chrysler each own stock in several other automobile companies, each of which operates under its own name. But the holding company has the entire control of the subsidiary company because it owns a majority of the stock of the corporation.

A *merger* takes place when the stockholders vote to dissolve their corporation and to sell the assets to another corporation. The company that purchases the assets pays for the assets by issuing stock to the former stockholders of the dissolved corporation. Thus the former stockholders in the dissolved corporation become stockholders in the other corporation. Or the stockholders in the dissolved company may be paid in money or in the bonds of the purchasing company.

Sometimes the assets of two or more corporations are combined by *consolidation*, which involves the formation of an entirely new corporation. In this case each of the corporations to be combined is dissolved, and the assets of each concern are turned over to the new company, each stockholder receiving a certain number of shares of stock in the new company.

Big Corporate Business Has Advantages. It is estimated that, on the basis of the money value of the products, corporations manufacture more than 80 per cent of all the goods produced by factories in the United States. They also employ about the same percentage of all labor used in manufacturing. Although approximately 50 per cent of the manufacturing estab-

lishments are operated as partnerships, the value of the goods they produce is only about 8 per cent of the value of all the goods made.

In a recent year the number of stockholders in the American Telephone and Telegraph Company exceeded 645,000. At the same time General Motors had over 300,000 stockholders. As long ago as 1929 the value of the assets of the former company was about two and one-half billion dollars. The assets of the latter amounted to more than one and one-quarter billion dollars. And while these corporations are much larger than most, there are others in the billion-dollar class.

We cannot say that huge business concerns are necessary in order to produce goods and services economically. But it is true that large-scale production makes it possible to produce many articles that can be sold at lower prices than they could be if production were carried on in small establishments. Most single proprietorships and partnerships could not command sufficient capital to provide the huge plants needed to produce goods on a large scale and at low prices. Hence the public may benefit from large-scale production in the way of lower-priced goods and services.

Several Evils Have Resulted from the Growth of Big Business. It is not surprising that the growth of large corporate businesses has been accompanied by several evils. In some large corporations individuals have used the powers of business selfishly and unscrupulously.

Unfair Competition. Some large corporations have not always used their powers justly in competing with other concerns in the same kind of business. Large chain organizations, manufacturing concerns, transportation companies, and other big corporate organizations have sometimes pursued unethical, and even illegal, practices in dealing with competitors. "Cut-throat" competition and bribery are two of the methods that have been resorted to on various occasions.

When corporations have been able to smother competition, they have sometimes charged unreasonably high prices for their goods. In this connection, however, it is well for us to

realize that perhaps corporations are, on the whole, no more guilty of unethical business practices than are single proprietorships or partnerships. Under the spur of competition for profits, there is always the possibility that some concerns, whether corporations, single proprietorships, or partnerships, will take improper advantage of their competitors.

"Watered" Stock. Sometimes the par value of the stock of a corporation is grossly overstated. Such stock is said to be *watered*. An example will illustrate the meaning of this term. Suppose Jones, Smith, and Williams own a small factory that has a fair valuation of \$100,000. They form a corporation with capital stock of \$500,000. Then they sell the factory to the corporation, taking all the capital stock in exchange. If the par value of the stock is \$100, the real value is only \$20, the remaining \$80 being "water," or the amount by which the value of the stock is overstated. Under these conditions anyone buying a share of the stock at par value from Jones, Smith, or Williams would pay more for the stock than it is worth.

Abuse of Powers by Directors. The stock of large corporations is held by widely scattered individuals. If a stockholder owns ten or fifteen shares, or even more, and the meeting of the stockholders is to be held at a place far from where he lives, he will probably not attend the meeting. If he does attend, he probably is at a loss as to how to vote on proposed measures or for members of the board of directors. Thus, while the corporation is democratic in theory, it is usually controlled by a relatively few large stockholders who determine the election of the board of directors

Upon the directors rests the responsibility for the proper and just conduct of the affairs of the business. The law imposes penalties for the wrongful use of their powers. But, without violating the letter of the law, a board of directors often can, if it so desires, use the capital of the corporation for the benefit of a few members and to the detriment of other stockholders. For example, it may vote to give the officers unreasonably large salaries and "bonuses." In recent years the heads of some of the large corporations have re-

ceived seemingly exorbitant salaries and bonuses of more than a million dollars. There are many other ways in which the directors may disregard the rights of stockholders without laying themselves open to prosecution in the courts. The abuse of the rights of minority stockholders has resulted in a demand for laws that will prevent the misuse of power by the directors of corporations.

QUESTIONS ON THE CHAPTER

1. Why is it said that this is an age of "big business"?
2. How has the Supreme Court defined a corporation?
3. State briefly the early history of the corporation.
4. How may corporations be classified?
5. What are the steps in the formation of a corporation?
6. What are some of the provisions that should be contained in the application for a charter?
7. How is a corporation managed?
8. Distinguish between par-value stock and nopar-value stock.
9. What is the meaning of each of the following terms? (For other terms defined in this chapter see Question 16.)

   (a) **board of directors**
   (b) **business corporation**
   (c) **by-laws**
   (d) **capital stock**
   (e) **charter**
   (f) **dividend**
   (g) **eleemosynary corporation**
   (h) **nonprofit corporation**
   (i) **officer**
   (j) **par value**
   (k) **par-value stock**
   (l) **private corporation**
   (m) **public corporation**
   (n) **stock**
   (o) **stock certificate**
   (p) **stockholder**
   (q) **surplus**

10. What are the rights of a holder of common stock? of preferred stock?
11. Distinguish between participating and nonparticipating preferred stock. Between cumulative and noncumulative preferred stock.
12. Distinguish between stocks and bonds.
13. What are the advantages and the disadvantages of the corporate form of business organization?
14. In what ways may corporations combine?
15. What evils have resulted from the growth of big businesses?

16. What is the meaning of each of the following terms? (For other terms defined in this chapter see Question 9.)

(a) **bond**
(b) **common stock**
(c) **consolidation**
(d) **cumulative preferred stock**
(e) **debenture bond**
(f) **holding company**
(g) **liquidation**
(h) **merger**
(i) **mortgage bond**
(j) **noncumulative preferred stock**
(k) **nonparticipating preferred stock**
(l) **nopar-value stock**
(m) **participating preferred stock**
(n) **pool**
(o) **preferred stock**
(p) **pyramiding control**
(q) **subsidiary company**
(r) **trust**
(s) **watered stock**

APPLICATIONS OF THE CHAPTER

1. What businesses in your community are conducted by corporations?
2. What have you read recently in newspapers or magazines concerning corporations? Discuss.
3. Explain why the prices of stocks, especially common stocks, fluctuate more than do the prices of bonds. Consider the rights and privileges of both bondholders and stockholders. Consult the financial pages of a daily newspaper of a large city.
4. A widely known lawmaker recently proposed to "tax all large corporations out of existence." Discuss the consequences that might result if such a measure were put into effect. Consider: (a) the investors in corporations (stockholders and bondholders), (b) the public, and (c) the government.
5. Discuss the need for high ethical standards among directors of corporations. Why is not business ability a sufficient recommendation for a director of a corporation?
6. Recently it was proposed to "soak the rich" by imposing high taxes upon large corporations. How would high taxes on corporations affect people other than the very rich? If you wanted to invest your savings in corporate stock, would you be likely to invest them in the stock of a large or a small corporation? Why?
7. Certain politicians have proposed that the large corporations, like the General Motors Corporation and the United States Steel Corporation, be broken up by the imposition of heavy taxes. They believe that these large companies should be made to reorganize as small independent corporations. What would be the effect of such reorganization on the prices of

articles produced? What would be the effect on the stockholders of the corporations? Would the passage of a law that caused such reorganization result in the destruction of property?

8. What is the attitude of people you know toward corporations? Why?
9. It has been said that public-utility companies and other corporations have encouraged people of moderate means to buy stocks so that laws opposed by the corporations might not be passed. How would the ownership of corporate stocks by the public tend to prevent the passage of laws that were undesirable to the corporations?
10. If a person owns stock in a steel company, is he likely to care whether the company makes a profit from the manufacture of munitions or from the manufacture of structural steel? Of what significance is this question from the standpoint of the prevention of war? from the standpoint of the relation of business to the public good?

TOPICS FOR SPECIAL REPORTS

1. The history of a large corporation. (For example, the United States Steel Corporation, the Bethlehem Steel Corporation, the Standard Oil Company, the American Telephone and Telegraph Company, or the American Radiator and Standard Sanitary Company.)
2. The influence of corporations on the lives of working people.
3. Large-scale versus small-scale business.
4. Why some people are generally antagonistic to corporations.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should the larger corporations (for example, the United States Steel Corporation, the Ford Motor Company, General Motors, and the American Telephone and Telegraph Company) be compelled to break up into smaller companies independent of one another?
2. Do high taxes on large corporations greatly affect consumers?
3. Should all holding companies be abolished?
4. Do the large corporations try to influence legislation more than do other types of business concerns or groups of individuals.

CHAPTER 9

CO-OPERATIVE SOCIETIES

The grocer who sells us butter, eggs, bread, and other kinds of food expects to make a profit. He assumes the risk of making the goods available for his customers, and any profit he makes is a reward for his service in maintaining his store. And, as we have pointed out before, the object of the owners of other kinds of business is to make a profit.

In the case of most kinds of private business the owners supply goods or services that are used mainly by their customers, who as a rule own no part of the business. Frequently the owners use little or none of the services or goods they sell to the public.

There are, however, some kinds of business that are run primarily for the purpose of providing services to the owners of the businesses. Such concerns are usually referred to as *co-operative societies* or *co-operatives*. They are co-operatively owned; that is, they are owned by the members whom they are mainly intended to serve. Co-operative societies engage in various kinds of activities including selling and buying commodities; providing credit for members; manufacturing; operating automobile service stations; providing medical services; maintaining funeral associations; operating housing associations; providing rooms, board, and supplies for college students; building and maintaining electrical power plants; supplying insurance for members; and others. Within recent years the growth of co-operative societies has been sufficient to cause many people to refer to it as "the co-operative movement."

The Co-operative Movement Originated in England. People have engaged in co-operative undertakings for a long time. But it is generally recognized that the idea of the co-operative society as we are using the term had its origin in England in 1843. At that time in Rochdale a small group of poor, un-

employed weavers met and discussed the possibilities of improving their condition. They had very little money, and the prospects of work were uncertain. Under the circumstances their situation was difficult.

These "Rochdale Pioneers," however, must have been either courageous or reckless individuals. For they decided to become businessmen. To men who had never earned more than the equivalent of $1.50 per week, this was a momentous decision.

At the beginning, twelve of the weavers subscribed the equivalent of 4 cents a week. After more than a year the number of subscribers had increased to twenty-eight, and the total of the subscriptions amounted to $140. With this amount they rented the ground floor of an old warehouse for three years. After paying the rent, they had $70, which they invested in flour, butter, meal, and sugar. One of the members of the society was elected to run the store, which was kept open two nights a week. The store was opened in 1844.

For a long time the going was rough for the Pioneers. Their neighbors had little faith that their attempt to run a co-operative store would succeed, and no doubt the merchants laughed at the idea that a few poor weavers could succeed in business.

Fifty years later, however, the membership in the Rochdale society had increased to 12,000, and the amount of yearly business to over $1,500,000. The savings, or profits, to the members was $300,000 annually. By 1922 the membership had increased to 26,000, and the annual amount of business was $4,000,000. Moreover, in the meantime another similar society had grown up in Rochdale, which had become almost as large as the first.

Before the war, there were 37,000 co-operative societies in various countries of the world, with a total membership of about 75,000,000 persons. In 1935 the Co-operative Wholesale Society of England had over 6,000,000 members and over £100,000,000 in capital. The net sales to members that year totaled more than £98,000,000, and the savings to the members, over £2,000,000.[1]

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[1]Gee, Wilson, *Social Economics of Agriculture,* The Macmillan Company, New York, 1942, p. 343.

The Rochdale Principles Are Simple. The principles upon which the Rochdale co-operative operated have been generally adopted by similar co-operatives all over the world. These principles are only three in number and are very simple. They may be stated as follows:

1. One man, one vote. Regardless of how much stock a member might own, or of how much business he might transact through the association, he could exercise no more influence in the control of the business than any other member. This meant that the control of the business was democratic.
2. Limited amount of interest on capital invested in the society. Each member was to receive an amount of interest equal to the lowest interest rate being paid for borrowed money by other business borrowers at the time.
3. Savings, or profits, to be paid to members in the form of dividends in proportion to their patronage. That is to say, if one member bought twice as much merchandise through the co-operative, he would receive twice as much dividends as the other. Such dividends are known as *patronage dividends.*

Co-operative societies engage in a continuous campaign of education by which they cultivate the loyalty of their members and advertise their claims as to the advantages of co-operation. Consumers' co-operatives sell for cash and at market prices, and not at cost. It is a rule that financial records must be audited at regular intervals and the figures made available to the members. Co-operatives aim to expand, and in order to do so, a part of the total savings or profits are retained in the business.

Co-operatives Are of Four Kinds. For convenience, the many kinds of co-operative societies may be classified into four groups: consumers' co-operatives, producers' co-operatives, marketing co-operatives, and credit unions.

Consumers' Co-operatives. *Consumers' co-operatives* are organized for the purpose of purchasing commodities and serv-

A Co-operative Grocery Store

Co-operative stores are the most common type of commodity co-operatives.

ices for their members. In some cases nonmembers may buy from a consumers' co-operative, but they do not share in any dividends that are distributed to the members.

The most important commodity co-operatives are those that buy groceries and general merchandise, gasoline and oil, and farm supplies. The most important service co-operatives are those that provide medical services, funeral services, houses and apartments, and campus co-operatives for college students. And there are several consumers' co-operatives that are used to provide rural electric light and power, telephones, and insurance.

By far the most important of the consumers' co-operatives are those that are used for the purchase of farm supplies and petroleum. In 1942 the total purchases of these commodities amounted to nearly a half billion dollars. In the same year the Southern States Co-operatives handled $17,000,000 worth of supplies. The Co-operative G. L. F. Exchange, of Ithaca, New York, had 125,000 members, who purchased $60,000,000 worth of supplies through the co-operative.

Some of the consumers' co-operatives maintain testing laboratories and kitchens for testing food products. Only those goods that pass the tests are labeled CO-OP and sold in the co-operative stores. In Minneapolis the Midland Co-Op Wholesale has samples of all its canned goods checked and graded according to government standards at the State Bacteriological Laboratory in St. Paul.

The following statistics, prepared by the Co-operative League of the U. S. A., give some idea of the extent and the nature of consumers' co-operatives in the United States in 1942.

CONSUMERS' CO-OPERATIVE ASSOCIATIONS, 1942

TYPE OF ASSOCIATION	NO. OF ASSOCS.	MEMBERSHIP	VOLUME OF BUSINESS
Commodity Co-Ops:			
Co-operative stores	3,100	485,000	$129,650,000
Service stations and petroleum co-ops	1,500	480,000	92,875,000
Farm supplies, less petroleum	1,149	420,000	355,325,000
Other commodity co-ops	50	25,000	5,800,000
	5,799	1,410,000	$583,650,000
Service Co-ops:			
Medical co-operatives	30	15,750	345,000
Funeral associations	40	32,500	200,000
Housing associations	60	3,750	2,530,000
Campus co-ops and others providing room and board	380	110,000	3,750,000
Miscellaneous service co-ops	150	15,000	160,000
	660	177,000	$ 6,985,000
Specialized Consumer Co-ops:			
Rural electric co-ops	700	575,000	16,650,000
Credit unions	9,510	2,816,000	302,339,000
Telephone co-operatives	5,000	330,000	5,485,000
Co-operative insurance associations	1,800	6,800,000	103,375,000
	17,010	10,521,000	$427,849,000

Producers' Co-operatives. During recent years the term *producers' co-operatives* has been applied to various associations of fruit growers, farmers, dairy owners, creamery operators, and others. Many of the attempts to carry on manufacturing by co-operative societies in the United States have not been successful. On the other hand, some kinds of agriculture and manufacturing have been successfully carried on by co-operatives in the British Isles, Denmark, Sweden, Norway, and Finland, and also in some other European countries. The Co-operative Wholesale Societies of England and Scotland own retail stores and factories that, before the war, employed over a quarter of a million workers. They own farm land in England, tea plantations in Ceylon, and grain elevators in Canada, as well as a merchant fleet. Among the more successful attempts at manufacture in this country by co-operatives have

been some that have undertaken the manufacture of commercial fertilizer and feedstuff.

It is usually said that the reasons why co-operatives have not achieved success in the field of manufacturing are lack of adequate capital and lack of ability on the part of management.

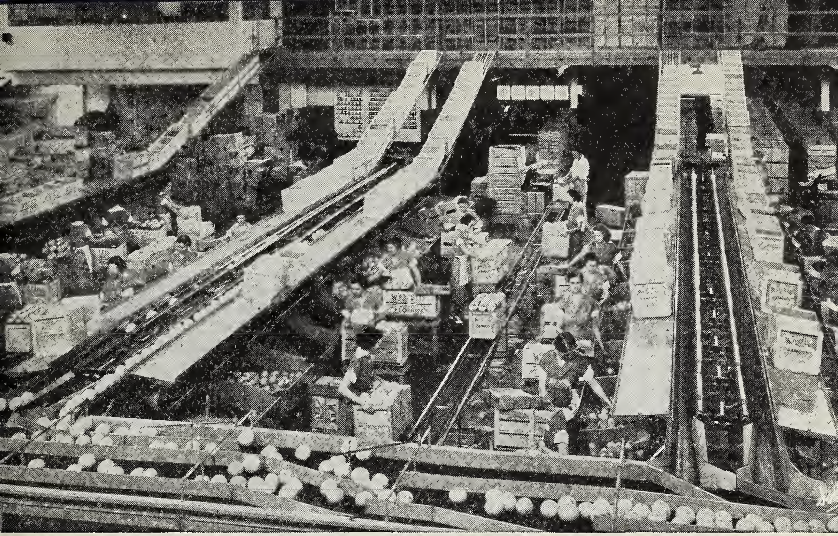
Marketing Co-operatives. *Marketing co-operatives* pool the products of their members. When the produce, such as wheat or oranges, is turned over to the co-operative, it becomes the property of that organization. The co-operatives are controlled by those who contribute the products to be marketed. In most cases the "one man, one vote" principle is used, regardless of how much of a product a member contributes.

The objectives of marketing co-operatives are to lower marketing costs, to improve the quality of goods by means of accurate grading, to increase bargaining power of the seller, and, in the case of certain crops such as citrus fruits, to expand the market by means of advertising.

The products marketed by farmers' co-operatives consist principally of the following: dairy products; grain, dry beans, and rice; livestock; fruits and vegetables; cotton; poultry and eggs; nuts; tobacco; and wool and mohair.

We do not have space to name all of the important farmers' marketing co-operatives. Among the largest of these organizations, however, are the California Fruit Growers' Exchange, the Farmers' National Grain Co-operative, the American Cotton Co-operative, the Dairymen's League, and the Land O'Lakes Creameries.

It is in the field of marketing agricultural products, as well as in purchasing farm supplies, that the co-operatives in the United States have achieved their most outstanding success. In 1942 there were 7,824 farmers' marketing co-operatives and 2,726 farmers' purchasing co-operatives, with a total estimated membership of 3,600,000. The total estimated business of these organizations amounted to $2,840,000,000. Although these co-operatives are to be found in all parts of the country, they are most numerous and strongest in Minnesota, Wisconsin, Iowa, Illinois, California, Ohio, New York, Missouri, Indiana, and Michigan.



Dahlgren

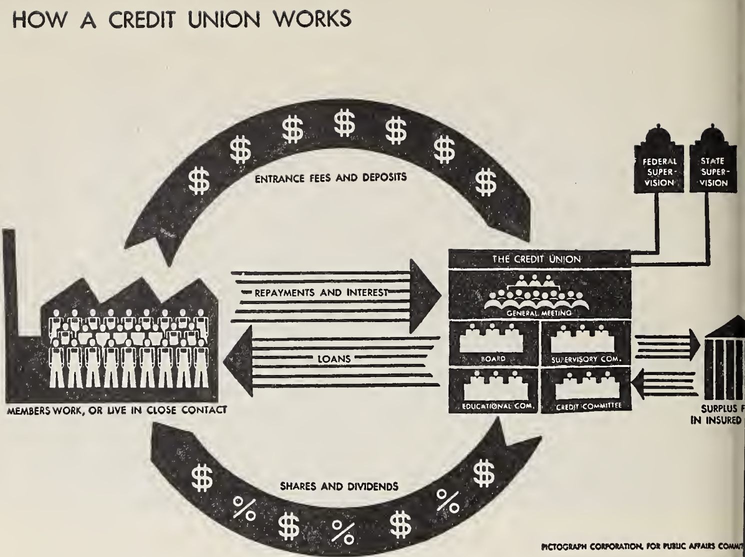
Grading and Packing Oranges

Most citrus fruits are sold through co-operative marketing organizations.

Credit Unions. *Credit union* is the name given to a co-operative organization that is designed to encourage its members to save and to provide loans to its members at a low interest rate. Credit unions are usually formed by members engaged in the same occupation, such as farmers or the employees of a large company. They are sometimes formed by the members of religious or educational organizations.

The idea of the credit union originated in Europe. It is claimed by The Co-operative League of the U. S. A. that the credit-union movement on this continent had its origin in 1900 at Levis, Quebec. In that year Alphonse Desjardines organized what was called the "Peoples Bank," which adopted the principles upon which present-day unions are organized. In 1909 Desjardines helped to draft a bill to authorize the organization of credit unions in Massachusetts. In 1921 Edward Filene, a Boston merchant, gave a large sum of money to encourage the credit-union movement. In 1932 Congress passed the Federal Credit Union Law, which was intended to encourage the formation of co-operative credit organizations. At present, nearly all the states have laws for the organization of credit unions.

The capital of credit unions is supplied by the members through the purchase of shares, usually at $5 each. The control



of the credit union is in the hands of its members, each of whom has only one vote regardless of the number of shares he owns. Only members may borrow from the credit union. As a rule, no security is required of borrowers on amounts up to $50. The interest rate charged on loans is determined by each credit union. Many of them charge a rate of 1 per cent per month. At the end of the year the net earnings are used for certain kinds of reserves, and the remainder is divided among the members.

The growth of credit unions has been rapid. In 1942 the number of these organizations was about 10,000, with more than 2,816,000 members. The total capital owned by the credit unions was more than $300,000,000.

Should Co-operatives Be Taxed the Same as Corporations? In recent years the co-operative movement has been so rapid that some private businessmen feel that the movement may seriously threaten the continued existence of private business enterprise. Moreover, the charge has been made that the Federal Government has shown favoritism in its attitude toward co-operatives. Co-operatives have been able to obtain loans from the Government at low interest rates, and they do not have to pay taxes on their savings—which many business-

men say are profits. As a consequence, it is pointed out, co-operatives that choose to go into the field of production and the wholesaling of merchandise enjoy advantages that are denied private business enterprise.

Within recent years the local buying and selling co-operatives have organized federations and centralized regional associations. These *super-co-operatives*, as they have been called, often perform wholesaling functions for the local organizations. The federations and regional associations of co-operatives also operate hundreds of oil wells, pipe lines, oil refineries, canneries, saw mills, feed mills, bakeries, and many other kinds of plants.

In many cases, it is said, the large co-operatives do not distribute all of their savings to the members. Most of the savings, it is claimed, are retained by the co-operatives and used to enlarge their plants and thus become stronger competitors of private business. These savings that are retained by the co-operatives, as well as those that are paid out to the members, usually are not taxed. But many of the large corporations must pay more than half of their net profits to the Government in the form of taxes.

The co-operatives, in reply to the charge that the Government is partial to them, say that "savings" are not profits. They say that the members, through their associations, buy and sell to themselves. In the case of the savings that result from production by producers' co-operatives, for example, it is claimed that goods are produced at a saving and that the savings are not profit. It is further argued that, if the members wish to use their savings to enlarge the business of their co-operative, the savings thus used should not be taxed.

Will Co-operative Societies Become More Important in the Future? This is a question that cannot be answered with assurance at the present time. It is true that in some fields the co-operative movement has gained much headway during the past twenty-five years. And there are those who expect that, as the country recovers from the effects of the war, the co-operative movement will take on renewed energy. It is often claimed that only by co-operative effort can consumers obtain many of the services they need at reasonable prices. For ex-

ample, many point to the inability of large numbers of people to secure adequate medical attention, and they say that only by group insurance and co-operative medical associations can they afford proper medical attention.

On the other hand, critics contend that the co-operative movement is not likely to become much more important than it now is. Most of those who find fault with the co-operatives as they now operate offer the following contentions:

(1) Management, they say, in private business is more efficient than it is in co-operatives; therefore the co-operatives cannot produce and sell goods at lower prices than private business concerns.

(2) Even if co-operatives can save members a few cents on the dollar, American consumers on the whole are not willing to forego the opportunity to "shop around," nor are most people willing to assume the responsibility of taking a part in the management of a co-operative enterprise.

(3) The American people move around a great deal; therefore, it is claimed, they will not keep up their membership in co-operatives.

(4) Many co-operatives have received favors from the Government, it is said, in the way of tax exemptions and loans of money. It is often said that when the public comes to realize this fact, these favors will be withdrawn and the co-operatives will be forced to compete with private enterprises, which, it is claimed, are more efficient.

(5) Finally, it is sometimes said that the co-operative movement is communistic in its nature. This last charge is perhaps the one that is most likely to result in heated controversy. Most of the members of co-operative societies disclaim any belief in communism, for, as they point out, communism means the ownership by the state of all goods, including both producers' and consumers' goods. They contend that most co-operative members believe in private property; for example, they say that farmers who belong to co-operative marketing associations believe as strongly in private property as do those who own banks and factories.

The co-operative movement has been indorsed by the Federal Council of Churches of Christ in America, the National

Catholic Rural Life Conference, The Central Conference of American Rabbis, the American Federation of Labor, the Congress of Industrial Organizations, the Railroad Brotherhoods, the Grange, the Farm Bureau Federation, the National Farmers Union, and the National Education Association. Whether the movement will become increasingly important will depend, perhaps, largely upon whether goods and services can be obtained at lower cost by means of co-operative effort than by dependence upon enterprises that are owned and operated primarily for profit.

QUESTIONS ON THE CHAPTER

1. What is the object of business owners and managers?
2. What is the primary purpose of a co-operative society?
3. In what kinds of activities are co-operative societies engaged?
4. How and when was the first co-operative society formed?
5. Did the Rochdale Pioneers succeed? Was the growth of the society rapid?
6. What were the underlying principles of the Rochdale Society? Have the principles been adopted by modern co-operative societies?
7. For what purpose are consumers' co-operatives organized?
8. What are the most important types of consumers' co-operatives? What is the most important single kind of consumer co-operative in the United States?
9. What have been the most successful kinds of producers' co-operatives in this country?
10. What are the objectives of marketing co-operatives?
11. How do credit unions operate?
12. What reasons are there for believing that co-operative societies will become more important in the future?
13. What reasons are there for believing that the co-operative movement will not become much more important in the United States than it now is?
14. What is the meaning of each of the following terms?

(a) **consumers' co-operative**
(b) **co-operative society**
(c) **credit union**
(d) **marketing co-operative**
(e) **patronage dividend**
(f) **producers' co-operative**
(g) **Rochdale Pioneers**
(h) **Rochdale principles**
(i) **super-co-operatives**

APPLICATIONS OF THE CHAPTER

1. If there is a co-operative store, credit union, farmers' marketing organization, co-operative hospital plan, co-operative recreation organization, or other form of co-operative society in your community, what is the main purpose of the organization? Why is it not run for profit? How many members are there? What benefits do the members derive? Do you know of anyone who is opposed to the society? What reasons do they give for their opposition?
2. Compare co-operative societies and private business corporations as to the following: (1) purposes; (2) ownership; (3) methods of management and control; (4) disposition of savings, or "profits"; (5) efficiency of management.
3. Are there any services that are needed by the people in your community that might be better supplied by a co-operative? If so, why has not a co-operative been formed to supply the service? If a co-operative were organized, do you believe the members would continue to show sufficient interest to give the organization a fair chance to succeed?

TOPICS FOR SPECIAL REPORTS

1. The organization and the work of the California Fruit Growers' Exchange.
2. Why consumers' co-operatives advocate grade labeling.
3. Using the *Readers' Guide to Periodical Literature* in your library, select and report on a recent article dealing with some type of co-operative society.
4. Report on the work of the Co-operative League of the U. S. A. Address: Chicago, New York, or Washington, D. C.
5. Report on the law in your state that authorizes the formation of co-operative societies.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Do co-operative societies render as much service as private business enterprises?
2. Is an increase in the number and the size of co-operative societies desirable?
3. Is it possible for a consumers' co-operative to be as efficient as an enterprise that is operated for profit?
4. Should government encourage the co-operative movement?

UNIT III

The Marketing of Goods

Methods by which goods reach consumers from producers in domestic and foreign trade.

Erie Railroad

The Marketing of Goods

Transportation is one of the important marketing functions.

CHAPTER 10

HOW GOODS REACH CONSUMERS

When we wish entertainment, we often go to a movie. But we should hardly expect to find diversion in a grocery store.

Still, if the contents of the bags, the bins, the cans, and the packages in a grocery store could only talk, they could furnish interesting entertainment. They could tell of places near and far.

Oranges could talk of the sunshine and the breezes in Florida or California. The cans of salmon might describe the cool waters of Alaskan rivers. From Spain the dates might bring a story of that romantic land. The bags of flour, bearing the name of any one of the cities famous for flour manufacture, could talk of the vast plains of the Middle West. And all the other articles on the shelves and in the boxes and the bins could speak of interesting places.

Besides describing their places of origin, the grocer's goods could talk about the truck, the railroad, and possibly the steamship that brought them to their destination. But this would not be all. They could also describe the various steps of harvesting, grading, manufacturing, and packing through which they passed before they were ready to be offered for sale.

Of course, we shall never hear from the goods in the merchant's store the story of their origin and experiences. But the fact that they are there is enough to suggest the question, How did they get there?

We shall not attempt to describe in detail the ways by which the many kinds of goods we use reach us. That would be too lengthy an undertaking.

We shall, however, seek to understand the movements of goods and the many things that must be done before commodities are available for our use. The movements of goods and the activities connected with these movements may be referred to as *marketing*.

Marketing Creates Three Kinds of Utilities. As we saw in Chapter 6, several kinds of utilities must be created before goods can be used to satisfy our wants. It is the business of some producers to create form utility primarily, although at the same time they also give other utilities to the goods they handle. For example, farmers and manufacturers change the forms of various kinds of materials, so that the materials become more usable.

But, as has been pointed out, form utility alone is not sufficient. Goods must also possess time, place, and possession utilities. Therefore after producers have created form utility, it is necessary to make goods available at the time and at the place where they are wanted and to enable those who will use the goods to acquire possession of them. As you can see, it is the business of retailers, wholesalers, elevator companies, railroads, and others to carry on the work of production. Those who buy and sell goods, supply transportation and storage, and perform other marketing services are often referred to as *middlemen,* which implies that they are between the producers of form utility and those who finally use the goods.

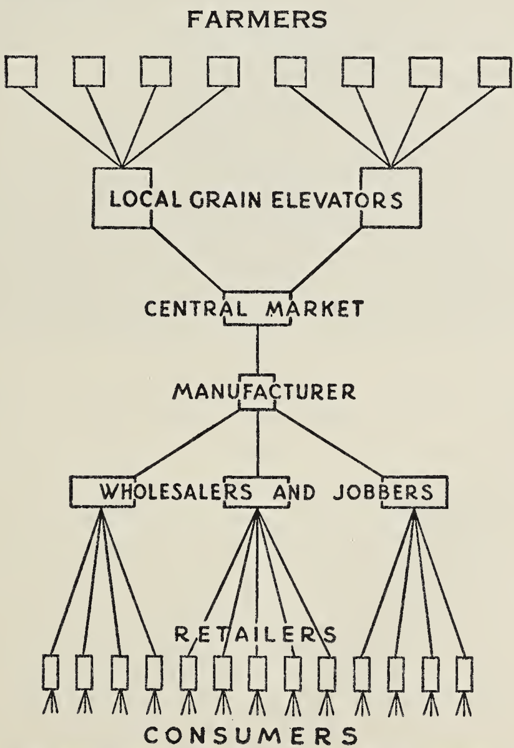
Marketing Involves Two Types of Movements of Goods. One of the movements of goods in marketing may be designated as that of concentration; the other, as that of dispersion.

Concentration. We can illustrate what is meant by this term by describing the processes in the marketing of wheat and flour. To begin with, the farmers grow the wheat. Although there are several ways in which the farmers may dispose of their wheat, we may assume that they sell it to an elevator company. The elevator company is a concern organized for the purpose of buying grain from farmers. After the local elevator company has accumulated a large amount of wheat, it sells the wheat to a large central market. The company may ship the wheat directly to the central market, or it may hold it until ordered to make shipment to the mill that has bought the wheat through the central market.

Up to this point it is apparent that the wheat has been undergoing the process of *concentration.* After having been grown by many hundreds of farmers, the wheat is sold to a

comparatively small number of local elevator companies. These companies then sell it to a still smaller number of central markets.

Dispersion. A relatively small number of flour mills buy the wheat and convert it into flour. The flour is sold to a larger number of wholesalers, who sell it to many local retailers from whom it is purchased by millions of consumers. Thus the flour is dispersed in a series of steps from the mills to the consumers. This process of *dispersion* of wheat products is indicated in the following diagram.



Concentration and Dispersion of Wheat and Its Products

This brief description of the marketing of wheat and flour is intended only to indicate the tendencies of concentration and dispersion that characterize the movements of practically all goods in the market. There are variations as to methods. For example, the flour might be sold either by the mill or the wholesaler directly to a bakery. Or the bakery might buy it from the retailer, make it into bread, and sell the bread to the consumer.

Other goods may not be handled by elevators or by the factories through which wheat products pass. But in one way or another they are ordinarily gathered together at some central point and then dispersed to the multitude of consumers. The work involved usually requires the services of many middlemen.

There Are Many Functions in Marketing. If we examine all the factors involved in getting the wheat from the farmer to the mill and in getting the flour from the mill to the consumer, we find that most of the functions performed by various individuals and concerns may be classified under the following six headings: (1) selling and buying, (2) grading and standardization, (3) financing, (4) transportation, (5) storage, and (6) risk bearing.

Every one of these functions must be performed by someone. Usually each of them is performed several times before any article is ready for use by the consumer. It often happens that one individual undertakes to perform more than one marketing function. In many instances, however, specialists undertake the performance of only one of the functions.

Selling and Buying. From the example of the marketing process given in the diagram on page 139, it can be seen that selling first takes place when the farmer sells his wheat to the local elevator and that it continues every time the wheat or its product changes hands, until the product is finally sold to the consumer. Likewise, every time the product is sold, it is also bought. There must be a purchase when there is a sale.

But the acts of selling and buying are performed by different parties, and the procedures are different. Selling sometimes involves the use of promotional activities in the form of salesmanship and advertising. Naturally at some stages in

Keystone View Company

Selling and Buying

The grocery store is the outlet through which the most important class of consumers' goods reaches us.

the marketing process promotional activities are not possible to the extent that they are at other stages. For example, the farmer has little opportunity to exercise any power of salesmanship or to engage in advertising when he sells his grain. It is possible that the local elevator is the only place at which he can find a market for his wheat. Furthermore, the price is usually determined in advance at the organized markets in Chicago, Kansas City, and other large cities.

The flour manufacturer, however, may employ a great deal of salesmanship and advertising. The large flour miller will more than likely engage in a national advertising campaign to stimulate the demand for his particular brand of flour.

Moreover, the salesmen who represent a flour mill or a wholesaler have an opportunity to present the merits of their flour in comparison with the quality of other brands of flour. And finally, the bakers and the retailers undertake to popularize their individual products.

The buyer of goods seldom advertises. His object is to seek out the source from which he can obtain the desired commodity at the lowest possible price consistent with the quality wanted. Buying for the purpose of resale, however, involves some problems that are different from those of consumer buying. The object, of course, in both cases is to obtain goods at the lowest price consistent with the quality desired. Buying raw materials for a factory or buying manufactured goods for a large store necessitates buying in large volume and according to the needs of the business, instead of buying in small quantities and according to personal wants. The buyer for a manufacturing or a merchandising concern is often a highly paid individual because the duties of the position call for ability of a high order. The job of buying by wholesalers and other middlemen is also one of importance.

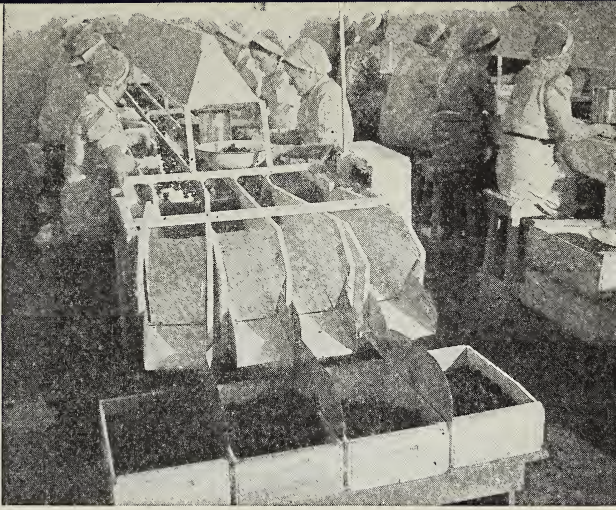
Grading and Standardization. When marketing is undertaken on a large scale, grading or standardization is necessary. Wheat, for example, must be separated according to its kind and quality. When it is graded, buyers of wheat can make their purchases from samples or according to description, with the assurance that what they buy will be the kind and the quality of wheat they want. Finally, after the flour has been manufactured, it must be put into standardized packages and containers for the convenience of the retailer and the consumer.

Many goods undergo grading and standardization several times before they reach the consumer. When, for instance, the farmer or the fruitgrower sells his produce, he makes some attempt to grade it. Vegetables, other farm products, and fruits are frequently subjected to further grading in the local markets and also in the central markets located in the cities. Mineral products from the mines must be graded before they are suitable for use by manufacturers. Lumber must also be graded according to recognized speci-

Grading

These women are grading olives in California.

U. S. Bureau of Reclamation



fications; otherwise manufacturers would be unable to obtain the quality of lumber they needed unless they examined every piece to be bought. These are only a few examples that indicate the need for grading and standardization. As in the case of buying and selling, grading and standardization are sometimes considered as two separate marketing functions.

Financing. Someone must be willing to put money into production before goods can be made ready for use. This fact is true of every type of production and of every stage of production—whether it represents the production of raw materials, the storage of goods, or the transportation of commodities. Someone must therefore make provision for financing the marketing as well as the manufacturing of goods.

There are several sources from which the funds needed in the marketing process are derived. Individual business concerns, commercial banks, and finance companies usually supply the money or the credit necessary.

Transportation. From the beginning to the end of the marketing process the problem of transportation is encountered. Of course, the act of transportation is usually performed by organized transportation systems. Since the costs of transportation must be borne by someone, the person who assumes the job of getting the goods to consumers should choose the most economical mode of transportation available. In order to make use of the most suitable means, the buyer or the

American Airlines

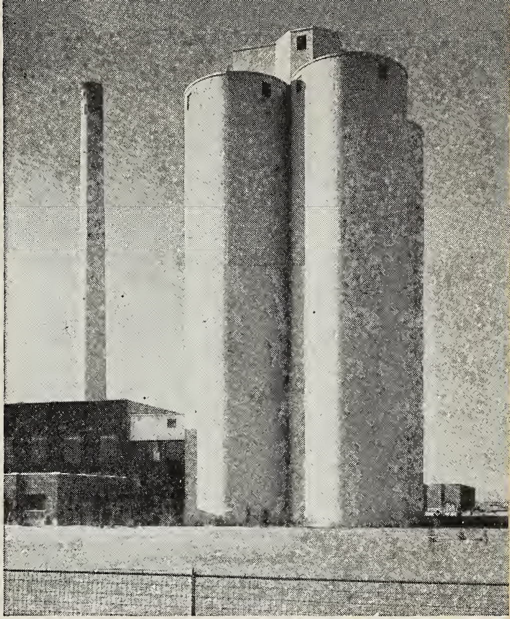
Transportation

Air transportation will play an important part in marketing activities in the future.

seller, as the case may be, must be familiar with the various kinds of transportation at his disposal. He must, therefore, have a knowledge of the existing kinds of transportation and must be familiar with the characteristics of the commodity that is to be transported. For example, lumber from the Pacific Coast region may be shipped either by rail or by ocean steamer to the eastern states; likewise, fruits may be shipped by either method. Because fruits are more perishable than lumber, it might be wiser to send a shipment of fruit by rail. It might be more difficult to decide which method to use in shipping lumber.

Storage. Goods do not move in a continuous stream to the consumer. At various points, periods of waiting are necessary.

Storage
The storage function in marketing is performed by these silos at a sugar factory.



U. S. Department of Agriculture

While the supply is being assembled (as in the case of wheat being collected at the elevator), it is usually necessary to provide storage facilities. Then, too, the factory or mill must keep a supply of raw materials on hand. After a product is manufactured, it must be stored by the manufacturer until wholesalers buy it; it must be stored by each wholesaler until retailers buy it; and it must be stored by each retailer until his customers buy it.

Different kinds of goods require different kinds of storage facilities. For example, conditions suitable for the storage of wheat would hardly do for eggs, animal products, or fruits. Storage facilities adapted to the needs of the product must therefore be provided.

So important is storage in the marketing process that specialized agencies for the performance of this function have developed. In addition to grain elevators for the storage of grain, such agencies provide warehouses, cold storage plants, stockyards, and poultry yards. Many of these facilities are owned and operated by concerns and individuals who make it their sole business to perform storage services.

The growth of specialized storage facilities is one of the developments that characterize modern marketing. Formerly it was not possible to keep available for a long period of time large quantities of perishable goods. Now, however, most vegetables, fruits, and meat products can be kept in a state of preservation for a great length of time because of the perfection of refrigerating devices.

In many instances the specialization of storage agencies tends to result in lower prices of goods. It also tends to stabilize the prices of commodities because perishable and seasonal goods can be kept available until they are needed. Still another result is that retailers do not, as a rule, try to keep a large supply of goods on hand, but depend upon central suppliers. This practice is more economical than keeping large quantities in stock.

Risk Bearing. When a person invests his money in any kind of property, he assumes the risk of ownership. If he buys goods for resale, they may be destroyed or the price may fall. In the marketing process the risk of ownership is ever present. During the time goods are on their way to consumers, someone must bear the risk of their ownership.

The greater the risk involved in the marketing of goods, the greater is the cost to the consumer. This result naturally follows because no one will undertake the purchase of goods for resale at any point in the marketing process unless he has reason to believe that he will make a profit. Hence, if in his experience his losses are high, he will need to charge enough for his goods to enable him to cover his expected losses and to leave him a profit besides.

There are several ways in which individual marketing risks may be minimized. First, modern marketing methods may be used. For example, the development of cold storage has in many instances practically eliminated risks due to spoilage. Second, individual risks may be reduced by the exercise of judgment. For example, a miller, through his knowledge of the supply of wheat and of the prospects of growing crops, may save himself from loss by buying at the right time. Third, insurance may be used to lessen risk. Not all risk can be avoided by insuring one's property, but the risk of total loss can often be reduced.

Economy in Marketing Affects Us All. Whatever reduces the cost of the functions necessary in the marketing process tends to reduce the cost of goods to the consumer. If a retailer, for example, discovers some ways in which he can reduce his risk or his storage or transportation costs, he will probably be

able to reduce the price that he will ask for his goods. And thus it is all along the line that goods travel to the consumer. Even though more economical methods of manufacture may be devised, goods will not become so cheap as they might be until all unnecessary wastes in the marketing process have been eliminated.

There Are Three Classes of Middlemen. Those who perform marketing services may be divided into three groups, as follows: (1) *merchants*, those who buy and sell goods on their own account, including wholesalers and retailers; (2) *agents*, those who buy and sell for others, such as brokers and commission men; and (3) *miscellaneous marketing agencies*, which may assist both merchants and agents, including railroads, warehouses, insurance companies, and banks.

Merchants. It is the business of a merchant to buy and sell on his own account. He takes title to goods and assumes the risk of their ownership.

Wholesalers are merchants who buy in large quantities for the purpose of reselling smaller quantities of goods to others who, in turn, will resell the goods. The wholesaler usually sells to retailers, although he may sometimes sell to other wholesalers. Wholesalers buy from manufacturers, farmers, and other producers, and from importers. They are engaged in the marketing of nearly all kinds of goods. Generally, however, they market consumers' goods more often than they do producers' goods.

The wholesaler performs many necessary functions in the marketing process. He usually specializes in a related line of merchandise, such as clothing of one or more kinds. He buys in large quantities, thereby reducing the transportation costs of the goods, and sells to retailers in his territory. His service makes it possible for the retailer to obtain a small quantity of goods without having to pay transportation charges from the factory on that quantity, which would be proportionately higher than the charges on the large volume of the wholesaler.

The wholesaler keeps a supply of goods available for the retailers in his territory. He thus assumes a great part of the

responsibility of providing storage facilities and takes much of the risk of changes in demand. He often extends credit to retailers. Through his services the manufacturer is relieved of a great deal of recordkeeping, correspondence, and investigation as to the reliability of the retailers, all of which would be necessary before sales could be made on account if the manufacturer undertook to sell directly to retailers. In addition, the wholesaler often performs the other functions that are necessary to the marketing process.

The *retailer* is the kind of merchant with whom we are most familiar. The position of the retailer is indeed one of great importance. In reality the retailer is the purchasing agent for the consumers whom he serves. In other words, the people rely upon retailers to buy for them and to keep on hand the goods that they will want. Instead of employing purchasing agents to buy things as they are needed, the people depend upon self-appointed purchasing agents, who take a chance of getting compensation in the form of profits.

Below is a list of the more important kinds of retail stores:

- Combination grocery and meat
- Motor-vehicle dealers
- Department stores
- Grocery stores
- Filling stations
- Restaurants and eating places
- Drugstores
- Lumber and building materials
- Fuel and ice
- Women's ready-to-wear
- Variety stores
- Radio dealers
- Hardware and implement stores
- Drinking places
- Furniture
- Men's clothing and furnishings
- Shoe stores
- Household and radio
- Accessory-tire-battery shops
- Family clothing
- Hay, grain, and feed
- Beer and liquor (packaged)
- Farm and garden supply
- Jewelry
- Cigar stores and stands

The importance of retail stores is indicated by the fact that there are more than 1,700,000 in the United States. On the basis of population there are more stores in the eastern and middle western states than in the western and southern states. Also, the per capita amount of purchases is much larger in the former two regions than in the latter two.

Essentially the retailer performs many of the same kinds of services as the wholesaler. The wholesaler assembles goods for dispersion to the retailers, while the retailer assembles goods for dispersion to the consumers. As in the case of the wholesaler, the retailer must possess specialized knowledge in his field of business.

Formerly the general merchandise store was the prevailing type of retail establishment in the United States. The population was then comparatively sparse; transportation was difficult; and the wants of most of the people were few and simple. Consequently that type of store served the needs of the people well. Modern methods of production and modern living conditions, however, have wrought changes in connection with the kinds and the quantities of goods produced and sold. Improvements in the means of transportation have made it possible for people to enlarge their shopping areas. The department store has become increasingly important in the cities, and chain stores sell more than one fifth of all goods sold by retail stores.

Agents. Brokers and commission men are agents who perform important functions in certain phases of the marketing process. A *broker* is an individual who brings the buyer and the seller together. He does not buy or sell goods for himself. It often happens that a seller does not know where the best market for his goods is located or that a buyer does not know the best source of the goods that he desires. These conditions often enable the broker to perform a valuable service in marketing.

As the broker is a specialist, he makes it his business to keep informed as to the location of possible buyers and sellers of particular kinds of goods. For example, a food broker must know the condition of the supply and the demand in various parts of the country for special kinds of foods, such as potatoes or canned goods. When the broker has brought a buyer and a seller together and has effected a sale between them, he receives a commission for his services.

Commission men receive goods on consignment and sell the goods to consumers. They receive a commission for their services. The commission man does not own the goods; but, unlike the broker, he usually has possession of the goods.

Miscellaneous Marketing Agencies. In a large measure, the marketing process involves all the agencies and the activities of business. Besides merchants and agents, there are many kinds of agencies that facilitate, or help, the buying and the selling of goods. These agencies include banks, which lend money to merchants and agents; railroads and highway trucks, which transport goods from one place to another; storage and warehouse facilities, which provide storage for goods until they are moved or until they are used; and insurance companies, which make it possible for merchants to avoid part of their risks by taking out insurance. Several of these agencies will be discussed in other chapters later in this course.

Is Speculation in Marketing Desirable? If you will look on the financial pages of a daily newspaper of a large city, you will find price quotations for wheat, cotton, corn, oats, and other commodities. You will notice that the prices are often given for a future month. These prices, however, are not the retail prices of the various products. They are the prices on the organized commodity exchanges, which are located in many of our large cities. An *organized commodity exchange* is simply a place where members of the exchange may meet to buy and sell commodities for immediate or for future delivery.

A sale of goods on the exchange for immediate delivery is called a *cash sale.* A sale for delivery at some time in the future is called a *future sale,* or merely a *future.* For example, a sale may be made in January for the delivery, or the transfer of ownership, of wheat in May. All transactions completed on the organized exchanges are made on the basis of standardized grades of commodities.

The Chicago Board of Trade is an exchange organized for the purpose of trading in grains. A member may sell wheat in January at, for example, one dollar a bushel and agree to make delivery in May. If the seller does not already own the wheat, he will, before the date of delivery, buy it from someone else. If he can obtain it, for example, at 96 cents a bushel, he will make a profit of 4 cents on each bushel. But if he has to pay more for the wheat than his selling price, he will suffer a loss. The possibility of making a profit is one of the chief reasons for trading on organized commodity exchanges.

The "Wheat Pit" in the Chicago Board of Trade

The "pit" is arranged so that the brokers may see each other. Offers to sell, bids to buy, and acceptances are indicated by outcry accompanied by gestures. On the walls are posted prices and foreign quotations. Tickers and telephone lines constantly bring in information that affects prices.

What Is the Case For and Against Market Speculation? Wheat and other agricultural products are seasonal. At harvest time more wheat is available than the millers can use at that time. If there were no speculators who were willing to buy the wheat and hold it for a while, the prices that the farmers would receive would be those that the millers were willing to pay. Since the supply at that time would be great, the price at harvest time would be lower than it would be later. Hence, individuals who are willing to assume the risk of ownership by buying and holding wheat, create a larger demand for it than there would be if the millers were the only buyers. The increased demand results in higher prices for the farmers at harvest time.

On the other hand, the fact that the speculators have supplies of wheat on hand that can be delivered during the

seasons when wheat is not being harvested keeps prices from going as high as they might if less wheat were available.

Naturally the speculators are in business for the purpose of making a profit. They can make a profit, however, only if the market fluctuates as they expect it to. A decrease in price is advantageous to those members of the exchange who wish to buy, while a rise in price benefits those who wish to sell. In financial circles those who would benefit by lower prices are known as "bears," and those to whom higher prices are an advantage are referred to as "bulls."

As a rule, speculators are guided by their judgments as to the way future prices will move. But either group, the bears or the bulls, by circulating rumors as to market conditions may try to influence prices so that they will move in the way that will prove most profitable. For example, the bulls might encourage the report of a crop failure in a certain part of the country in order to try to induce more buying of that particular commodity. When the bears get the better of the contest and prices are forced down by either fair or unfair methods, farmers may feel that speculation has caused the prices to go lower than they would have gone if there were no grain exchanges. When such is the case, speculation is considered an evil.

Attempts have been made either to destroy the organized exchanges by law or to impose drastic regulations upon them. The *Commodity Exchange Administration* is a Federal agency the function of which is to regulate future trading in wheat, rice, corn, barley, rye, flaxseed, sorghums, mill feeds, cotton, butter, eggs, Irish potatoes, and wool tops. Only licensed exchanges and brokers are allowed to operate. Prices are allowed to fluctuate only within the limits fixed by the Administration. False reports as to the demand and supply of a commodity are forbidden. The amount of trading by one person may be limited. If, in the opinion of the Administration, one person buys too much of a commodity, he may be ordered to sell part of it. Dealers are required to maintain correct records.

But in spite of these regulations all of the evils of speculation have not been eliminated. How to do away with these evils without imposing rules that would destroy the exchanges is still a question.

QUESTIONS ON THE CHAPTER

1. Explain what is meant by the concentration and the dispersion movements in the marketing process.
2. Explain and give an example of each of the following marketing functions: (a) selling, (b) buying, (c) grading and standardization, (d) financing, (e) transportation, (f) storage, and (g) risk bearing.
3. How are middlemen classified?
4. Give an example of each kind of middlemen and tell what he does.
5. Name as many kinds of retail stores as you can.
6. What are organized commodity exchanges?
7. How do organized commodity exchanges make speculation possible?
8. Is speculation desirable? Explain.
9. How are organized commodity exchanges controlled by law?
10. What is the meaning of each of the following terms?

(a) **agent**
(b) **broker**
(c) **cash sale**
(d) **commission men**
(e) **Commodity Exchange Administration**
(f) **concentration**
(g) **dispersion**
(h) **future sale**
(i) **marketing**
(j) **merchant**
(k) **middlemen**
(l) **miscellaneous marketing agency**
(m) **organized commodity exchange**
(n) **retailer**
(o) **wholesaler**

APPLICATIONS OF THE CHAPTER

1. In what ways do the topics of this chapter apply to conditions in your community?
2. What have you read recently in newspapers or magazines that pertains to the topics discussed in this chapter? Report on the articles that you have read.
3. "If we could get rid of some of the middlemen, prices would be lower." Discuss this statement.
4. What have you read in history on the subject of fairs in the eleventh, twelfth, and thirteenth centuries in England?
5. Do you think that greater progress has been made in the creation of form utilities than in the creation of time and place utilities?
6. It is sometimes said that a person should spend his money in the independent stores of his community, and not in the chain stores, because the money thus spent will then stay in the community. Discuss this statement from the following points

of view: (a) What becomes of the money paid to each kind of store? (b) How much of it goes to the wholesaler? (c) Do the people who work in both kinds of stores live in the community? (d) Do chain stores keep bank accounts in the towns or cities in which they are located?

7. What are some instances in which goods are sold directly from the factory to the consumer? When goods are sold in this manner, what are the advantages to the factory owners? to the consumers? What are the disadvantages? Why are not all goods sold in this manner?
8. Show that middlemen are as truly producers as are farmers, miners, or manufacturers.
9. Why do some merchants deliver goods to their customers, while others operate their stores on the "cash-and-carry" plan? How is the creation of utilities related to the two plans?
10. What advantages do department stores have over smaller stores? What disadvantages do department stores have?

TOPICS FOR SPECIAL REPORTS

1. Medieval fairs.
2. The Chicago Board of Trade.
3. The New Orleans Cotton Exchange.
4. Motor transportation as a factor in marketing.
5. Supermarkets.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Are chain stores of greater benefit to the consumers in a community than are independent stores?
2. Are farmers at a greater disadvantage in marketing their products than are manufacturers of metal products?
3. Should the Government establish grading standards for canned goods and compel dealers to use them?
4. Should the Federal government exercise less control of marketing?

CHAPTER 11

TRADING AT HOME AND ABROAD

Windsor, Canada, is separated from Detroit by a small river—and an international boundary line. A large modern bridge leads from the streets of the one city to those of the other. The people in the two places are very much alike in most respects. Perhaps they are more alike than are the people in many sections of the United States.

But there is not the freedom of trade between these two cities that there is between any two localities in the United States, however far apart the latter may be. If, for example, a dealer in the Canadian city buys an automobile in this country, or if a merchant in Detroit buys woolen goods in Windsor, each one will have to pay a tax before the goods can be brought into his own country. The taxing of goods imported from foreign countries is practiced by nearly all nations of the world.

These facts are known to nearly everyone. But the reasons why goods, as a rule, move freely from one state in this country to another, while taxes are imposed upon many kinds of goods coming into this country, are not well understood. What are the reasons?

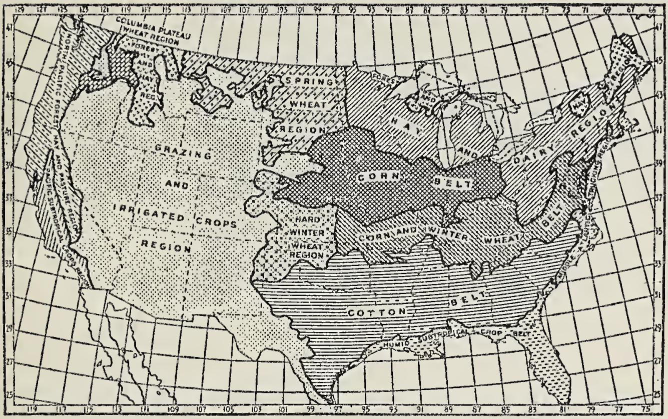
What Is the Underlying Cause of Trade? An intelligent discussion of the underlying cause of trade requires an understanding of the law of comparative advantage. The *law of comparative advantage* means that each region tends to produce that kind of product that, by nature and circumstances, it is best fitted to produce, and to buy the other things that it uses from the regions in which they can be produced more economically. It thus results in a territorial division of labor, which makes trade between regions desirable.

The law of comparative advantage has long been recognized. More than one hundred and fifty years ago, Adam Smith

discussed the law of comparative advantage in the following interesting manner:

"It is a maxim of every prudent master of a family never to attempt to make at home what it will cost him more to make than to buy. The tailor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs these different artificers. All of them find it to their interest to employ their whole industry in a way in which they have some advantage over their neighbors, and to purchase with a part of their own produce, or what is the same thing, the price of a part of it, whatever else they have occasion for. What is prudence in the conduct of every private family, can scarcely be folly in a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage."

Regions in the United States Differ in Resources. The advantages to be derived by following the reasoning expressed by Adam Smith have been demonstrated to a considerable extent in the history of industry in the United States. This country embraces more than three million square miles of territory that is adapted to the growing of a wide range of agricultural products. Differences in soil and climate render certain localities especially suited to the production of particular kinds of crops. In some places there is plenty of iron ore, coal, petroleum, and other mineral resources, while in others there is little or none of these. And in every case the energies and the capital of the people of each region tend to be used in the production of those things that the region is best fitted to produce. For example, parts of Florida and California are largely given over to the raising of oranges, while the middle western states produce wheat, corn, cattle, and hogs. As a result, everyone is able to obtain more bread and meat and oranges than he could if each region tried to produce everything it uses. The same tendencies and results are to be found in manufacturing.



Courtesy of U. S. Department of Agriculture

Agricultural Regions in the United States

This map shows how our nation is divided on the basis of the dominant use of the land in each area.

Trade Between the States Is Comparatively Free. One of the reasons for the adoption of the Constitution in 1789 was the desire on the part of many businessmen to eliminate trade restrictions between the states. Before the Constitution was adopted, many of the states levied taxes on goods imported from other states. As a result, trade wars were waged with bitterness. An outstanding example of commercial rivalry occurred in 1787, when New York levied taxes upon agricultural products from New Jersey and Connecticut. In retaliation the businessmen in New London, Connecticut, pledged themselves, under a forfeit of $250, not to ship goods to New York for a period of one year. The adoption of the Constitution made it illegal for a state to levy a tax directly on goods that are brought from another state.

It is generally agreed that the relative freedom with which goods move from one part of the country to another has been one of the important factors in the growth and prosperity of the United States. A far greater total amount of all kinds of goods can thus be produced and sold at a lower cost than would be

A Barrier to Interstate Trade

A state trooper at port of entry recording license and weight of truck before permitting it to cross state line.

possible if each region tried to produce all the things that it uses. As a result of regional divisions of labor nearly everyone is able to buy more goods than he could if each region endeavored to be self-sufficing.

At the same time, many of the states have placed certain difficulties in the way of interstate trade. For example, some states charge full registration fees on all trucks coming into the state. Some states have maximum grade requirements for fresh eggs that make it impossible for eggs to be classed as fresh unless they are laid in the state. In one state distillers must pay $1,000 per plant unless more than 75 per cent of the materials used are grown in the home state. Plants that meet this requirement are taxed only $25. These examples illustrate some of the ways by which many states attempt by law to encourage the growth of their home industries and to discourage trade with other states.

Regions of the World Have Different Resources. When we consider the whole world, we find that nations differ as to climate, soil, natural resources, and industrial development. In other words, the differences that account for specialization in production in the United States exist also among the nations.

As in the case of our states, some nations have a greater variety of natural resources and a more favorable climate than others. The United States and the Soviet Union possess vast territories that are rich in many kinds of ores and other resources needed for manufacturing. Considerable portions of the areas of both nations are still covered with forests. And

because of the presence of much fertile land and a variety of climatic conditions, both nations are able to produce many kinds of agricultural products. The British Empire, made up of dominions and possessions stretching around the earth, also embraces territory that supplies many materials for manufacturing. The agricultural lands in Canada, Ireland, Australia, New Zealand, South Africa, and elsewhere produce most of the farm products used by the people living within the Empire, as well as much that is exported to other countries.

Most countries are very dependent upon others for some kinds of essential goods. While they may possess rich resources of one kind or another, they are poor in other resources. For example, France is poor in nearly all kinds of metals other than iron, aluminum, and antimony. It has practically no copper, zinc, silver, lead, nickel, or tin. Germany must import a great many raw materials. Sweden is rich in iron ore, but only the southern third of the country is profitable for agriculture. Denmark is a flat, sandy country, with no coal, iron, or other minerals. But by intensive and intelligent effort the people have made it famous as a dairying nation that exchanges dairy products for most of the other products it needs. Italy has to import the great majority of the materials used in her factories. The need for more mineral resources caused Japan to try to take over much of the territory belonging to China, an act that helped to start World War II. The desire to get unlimited control of all the land and other natural resources they could use was the main reason why Germany, Japan, and Italy made war upon the rest of the world. Of course, they claimed that their people are superior to others and, for that reason, should rule others. But the economic reason—the desire for natural resources—was more important.

A study of the distribution of the natural resources of the earth enables us to see why *foreign trade*—that is, trade between nations—is so necessary if the people in the various nations are to enjoy the use of many kinds of goods.

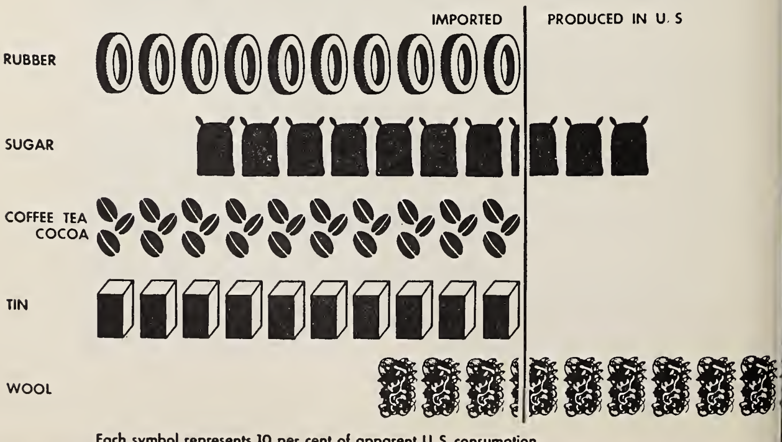
Our Imports and Exports Comprise Various Goods. It is sometimes said that the United States is almost self-sufficient, that it could get along without trading with other nations. And

it is true that we can and do produce the greater portion of most of the goods we use. From the beginning, however, this country has found it desirable to *import*, or buy, from other nations as well as to *export*, or sell, goods to them.

The most important kinds of goods that we sell to other countries consist of manufactured cotton, machinery, petroleum and its products, automobiles and parts, unmanufactured tobacco, chemicals, iron and steel products, fruits and nuts, coal and coke, copper and copper products, packing house products, manufactured rubber, paper and paper products. Our most important imports include crude rubber, raw silk, undressed furs, hides and skins, unmanufactured wool, oil seeds, unmanufactured tobacco, cane sugar, coffee, wines and spirituous liquors, grains, fruits and nuts, meats, dairy products, wood pulp, tin, vegetable oils, fertilizers, copper, precious stones, chemicals, paper, manufactured cotton, burlap, flax, hemp, woolen cloths, and works of art.

The size of exports or imports does not give a true idea of the importance of our foreign trade. For example, before the war we exported only about 10 per cent of the total amount of goods produced in this country. But of some commodities, like cotton and tobacco, we export a large percentage of the total amount produced. Likewise, we import only a small fraction of the total amount of goods we use. But some of these goods

WE NEED THE PRODUCTS OF OTHER LANDS



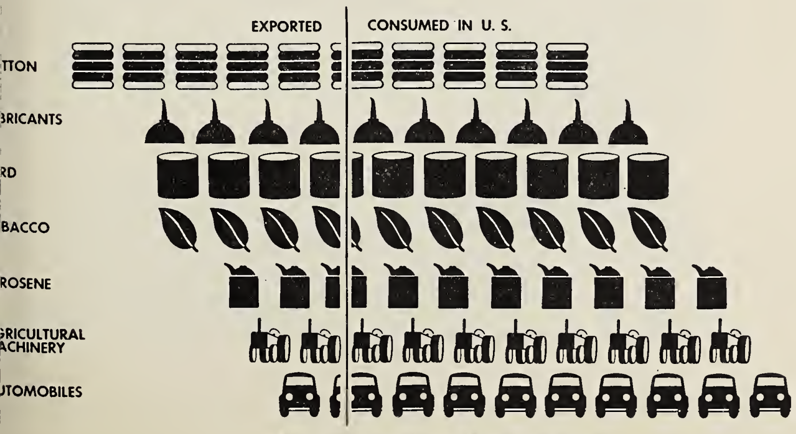
Pictograph Corporation for

are very important. For example, before World War II all the rubber we used was imported. When war came and we could no longer import rubber, it became necessary for the Government to limit the number of tires that people could buy. The Government and private business concerns spent hundreds of millions of dollars in the erection of synthetic, or artificial, rubber plants. At the present time we import the tin we use and extremely large amounts of certain other commodities.

Formerly most of our exports consisted of raw materials to be used by European manufacturers, and our imports were made up largely of manufactured goods. Now, however, manufactured goods comprise more than three fourths of our exports and a little more than one half of our imports.

All our coffee comes from foreign countries, most of it being imported from Brazil. Raw silk on a large scale is produced only in China and Japan. By far the greater part of our sugar is obtained from Cuba and the Philippines, although considerable quantities are imported from Puerto Rico and Hawaii. Most of our rubber comes from the Dutch and the English islands in the Pacific. Much of the manganese, nickel, cobalt, vanadium, tungsten, sodium, and other less commonly known metals and minerals, many of which are essential in the production of the new kinds of steel and of other manufactured products, is imported. Our own supplies of these materials are

/E GAIN BY SELLING BEYOND OUR BORDERS



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very limited. The supplies we have are of inferior quality, and it is expensive to utilize them.

During the war our supplies of rubber, silk, and sugar from the Asiatic countries were cut off. For some time, owing to German submarines, it was even difficult to get sugar from Cuba or coffee from Brazil.

As we shall see later in our study, the money that is received for goods that are exported is used indirectly to pay for those that are imported. In the long run, therefore, the value of the total exports from a country tends to equal the value of the imports. It is generally recognized that a nation must, over a period of time, buy from other nations just about as much as it sells abroad.

Why Are Imports Often Discouraged? We have seen that where the law of comparative advantage is allowed to work, a territorial division of labor results and trade between regions follows as a matter of course. There are a few people who hold that the law of comparative advantage should be allowed to operate unhindered. Those who believe in *free trade* contend that goods should be permitted to enter this country without the imposition of any tax whatever. They assert that, if goods are thus allowed to move freely from one country to another, each country will reap the same benefits as those that come to a nation from free domestic trade.

On the other hand, those who oppose free trade admit that the theory of free trade sounds plausible, but they contend that it would not work out to the best interest of a nation. Accordingly, by imposing taxes or *tariffs* on imports, they would discourage the importation of nearly all kinds of goods that can be produced in this country. In other words, by taxing imports, they would "protect" home industry.

The preceding opinions represent the two extreme points of view with respect to imports. Between the two extremes are all shades of opinions. Some favor a tariff for revenue only; that is, they hold that taxes should not be imposed for the purpose of discouraging imports, but only for the purpose of raising money for the Government. Others would levy taxes high enough to afford some protection to home production. And

in the case of certain items, they would make the tax high enough to prohibit all imports of those items.

There Are Arguments For and Against Protection. There have always been restrictions on the trade between nations. In the case of the United States, the history of the tariff has been an interesting story. The debates over our foreign-trade policies have been long and sometimes bitter, and most of the arguments for and against a "protective tariff" have been repeated many times. Those who favor a protective tariff are frequently referred to as *protectionists,* while those who oppose such a tariff policy are known as *antiprotectionists.*

Nationalism. One of the arguments advanced for protection is that this policy promotes *nationalism.* This argument assumes that an intensive spirit of nationalism is a good thing and that it should be encouraged. The nation that subscribes to nationalism exalts its own people and institutions and attempts to build up a spirit of national unity and independence. Emphasis is placed upon the desirability of making the nation self-sustaining and of encouraging the patronage of domestic industries. In order to appeal to the nationalism of the consumer, people are urged to buy home products. Such slogans as "Buy American," or, in England, "Buy British," are sometimes used.

The opponents of protection, on the other hand, insist that trade restrictions for the purpose of stimulating nationalism are undesirable for two important reasons. First, intense nationalism leads to a narrow outlook, to selfishness that breeds hatred, and, eventually, to war. Second, no nation can restrict commercial intercourse and at the same time promote to the highest degree the economic welfare of its people.

Moreover, it is pointed out that, unless we buy goods or services from other nations, the amount of our exports will decrease. Many persons claim that high tariffs are especially harmful to the farmers because, as they maintain, the less we buy from abroad, the less wheat, cotton, and tobacco can be sold to other countries.

The Home Market. Closely related to the preceding argument for protection is the contention that protection builds up a home market for the sale of commodities. It is said that the home market constitutes a more reliable and constant demand for products than does a foreign market. The former cannot be interrupted easily by wars, by the trade restrictions of other countries, or by foreign economic upheavals.

Those who oppose protection reply by stating that trade will seek foreign markets regardless of whether a nation has protection from imports. They point out that, since the Civil War, the United States usually has had a very high degree of protection in the form of high tariffs, and yet, until the business depression beginning in 1929, foreign trade increased more rapidly than it had during any previous period. Protective tariffs, it is said, may cripple foreign trade, but they cannot suppress it permanently or entirely.

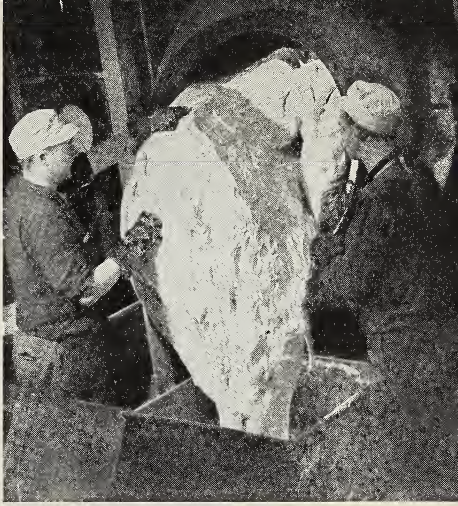
Military Necessity. The protectionists argue that protection is justified upon the grounds of war and military necessity. They point out that in case of war a nation may be shut off from foreign supplies of raw materials and finished goods. Consequently the people may suffer, and the lack of certain materials needed to carry on the war may result in defeat. Hence a nation should be as self-sustaining as possible.

On the other hand, there are those who hold that protection is one of the principal causes of international hatred and war. They contend that the effort of nations to become self-sustaining in anticipation of war only makes war that much more probable. Perhaps most of us would agree that these arguments are based on reason. No nation can become independent of other nations, unless it is able to get control of the resources that many other nations possess.

Infant Industries. The protectionists say that, because of resources and markets, certain industries would thrive in this country if those industries were given a start under favorable conditions. They contend further that, once these infant industries had acquired strength and momentum, they could produce commodities as cheaply as similar industries in other countries. It is maintained that, during the early years of the

A New Industry of World War II—
Synthetic Rubber Manufacture

Should this industry be protected from the competition of crude rubber?



E. I. du Pont de Nemours & Company

life of these industries, protection from the competition of foreign industries, which have been established longer, is needed. Moreover, it is said that in this way the industries in the country can be diversified.

In answer to this, those who oppose protection contend that, if the preceding argument were true, there would never have been any great spread in the location of industries in the United States. As an example, it is pointed out that comparatively recently the cotton textile industry has tended to migrate from New England, where it was first established, to the southern states. It is claimed that if the infant-industry argument were sound, the textile industry could not have grown up in the South without protection from the competition of New England factories. It is said further that, if infant industries are given protection, they never seem to reach a point where they are willing to have the protection removed. They are unwilling to give up profits that a protective tariff enables them to make.

Dumping. Within recent years much has been said about protection as a defense against dumping. *Dumping* refers to the sale of products in another country at a price lower than the cost of production at home. It is said that surpluses of goods are sometimes dumped on the foreign market at whatever prices can be obtained for them. It is charged that frequently a government, by offering a bonus or a subsidy, will encourage an industry to strangle or demoralize foreign competition by dumping its products on the foreign market.

In general, those who oppose protection agree with the protectionists in their attitude toward dumping. They point out, however, that the term "dumping" should not refer to the

mere sale of goods at a price lower than that which can be obtained in the domestic market. Extreme free traders contend that only when goods are sold below the actual cost of production and in an attempt to demoralize our industries should protection be sought.

The Protection of Labor. It is frequently said that a protective tariff is desirable in the United States in order to protect American labor against low wages prevailing in other countries. This argument is widely held, even by workers themselves. It is maintained that in certain cases the highly paid labor in this country cannot compete with the poorly paid labor in other countries.

To this argument the antiprotectionists reply that the protectionists are not consistent. They point out that the protectionists advocate a protective tariff to make possible the payment of high wages and then justify the high prices of commodities on the basis of the high wages. They maintain that labor competes with labor and not with commodities. The American laborer, because of his greater efficiency, which is partly due to the use of labor-saving machinery, is able to produce much more than the average foreign worker who is engaged in the production of the same kind of commodity. Hence, although the American worker may receive higher wages, he does so because he produces more goods. Therefore, except in the production of certain hand-made articles, such as art works and laces, the American laborer produces much more cheaply than does the foreign worker. Hence, the way to protect American labor is to restrict immigration.

In comparing wages and the productivity of workers in this country with those in other countries, we should recognize the fact that machinery is being used to an increasing extent in every country. By using modern machinery, foreign labor is made more productive. Therefore, if wages paid in foreign countries are not increased in proportion to the increase in production, foreign manufacturers are able in many instances, so far as the cost of labor is concerned, to produce goods more cheaply than American manufacturers can.

It is interesting to note that much of the improved machinery used in foreign countries is American-made. And

many factories of different kinds have been established by Americans in other countries, partly for the purpose of using cheap labor. The result is that the goods thus produced abroad by American-owned factories compete in the markets of the world with the goods made in this country. Among the American corporations that have factories in other countries are the Ford Motor Company, General Motors, International Harvester, and some of the meat-packing concerns. In many cases foreign governments and chambers of commerce have encouraged American businessmen to build factories within their countries.

Equalization of the Cost of Production. Another argument advanced by the protectionists is that protection should be utilized for the purpose of equalizing the difference between the cost of production in the United States and that of production in the principal competing countries. It is said that protection thus prevents underselling in our markets by those foreign producers who are able to sell goods here more cheaply than our domestic producers can produce them.

Critics point out that, while this policy has attractive features, it cannot be carried out with any degree of justice. The cost of production varies greatly among domestic producers. For example, Gould may be able to produce a commodity for one dollar, while Johnson may not be able to produce it for less than one dollar and a half. Which of these costs shall be taken as a basis for the calculation of a tariff rate? In other words, in the establishment of a tariff rate, whose cost of production shall be used in comparison with foreign costs? Besides, it is contended that the cost of production for the many individual establishments in the foreign countries could not be ascertained.

Governmental Revenue. Those who favor protection argue that the revenue obtained from a protective tariff helps to defray governmental costs. To this argument antiprotectionists reply that the policy of levying a tariff for revenue defeats its own purpose. If the protective tariff on any commodity is high enough to afford absolute protection, then that com-

modity will not be imported; and, hence, no tax will be collected. It is conceded that a tariff for revenue only may be desirable. At the same time, a tariff for revenue is unsatisfactory as a source of income to the Government because governmental costs usually are fairly constant, while revenues derived from foreign trade, which fluctuates a great deal, are unreliable and uncertain. For example, the value of our merchandise imports in 1929 was $4,400,000,000; in 1932, $1,323,000,000; and in 1941, $2,416,000,000.

In addition to these arguments against protection it is contended that protection fosters monopoly by making it possible for some producers to build up large businesses that are able to crush the competition from smaller producers.

What Foreign-Trade Policy Is Desirable? Most of the arguments for and against free trade contain elements of truth. This being the case, it is no wonder that the tariff issue has been a bone of contention in this country for more than a hundred years. Many of the arguments of the protectionists are based upon selfish motives. Some of the advocates of a policy of protection are interested primarily in their own individual gain. On the other hand, critics of protection may be equally selfish, and they sometimes fail to appreciate many of the practical problems involved in the controversy.

In spite of the difficulties involved in the question of protection versus free trade, the consensus of economists in this country seems to be that neither extreme protection nor absolute free trade is the solution to the difficulty. And perhaps most leading businessmen agree. Possibly a majority of those who are competent to pass judgment upon the matter are of the opinion that the high tariff policy of the United States that was pursued during the decade after 1922 was detrimental to the welfare of the American people. The degree of protection afforded in many instances was, no doubt, too high.

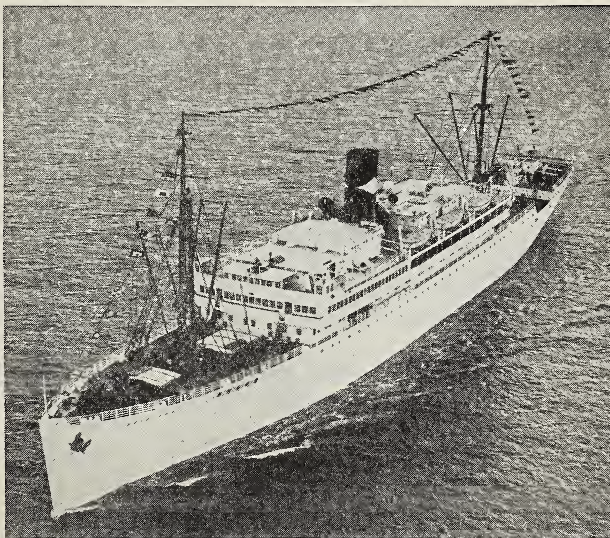
Politics and the Tariff. Possibly it is desirable to have an import tariff on certain commodities, but just how much the tariff should be is difficult to say. It is regrettable that tariff making has long been a political issue. All too often tariff rates have been fixed by the lobbying of manufacturers and

of others who desired protection. The charge has often been made that a congressman or a senator will vote for the protection of an industry in his own state and that tariff laws become compromises of political interests. It can readily be seen that this method of settling the question is not likely to result in a satisfactory solution to the problem.

Individual and Social Viewpoints. The root of the controversy over protection is the conflict between individual and social interests. To a New England manufacturer or to a Louisiana sugar grower a protective tariff may be beneficial. But protection will cause the prices of the protected articles to be higher for the consumer.

Moreover, a manufacturing establishment or an industry that has grown up under cover of a protective tariff will suffer if the tariff is removed or even lowered enough to permit foreign goods to enter this country and to compete with domestic goods. Stockholders and bondholders in the companies affected will suffer a loss in the value of their investments. And wages in the protected establishments will have to be reduced, and the workers may even be thrown out of employment.

Efforts to Regulate Tariffs Scientifically. A tariff that affords protection and profit to a manufacturer at the expense of



An Ocean Freighter —Symbol of Our Foreign Trade

Ocean transportation expands our markets and brings us goods from many foreign lands.

United Fruit Company

any class of consumers (that is, without affording a corresponding benefit to consumers) cannot be said to be just or desirable from the point of view of the welfare of the country as a whole. Before any protection is given, those applying for protection should be compelled to demonstrate that it will contribute to the general welfare.

Only scientific study can produce the right answer to the tariff problem. An effort in this direction was made in 1916 when Congress established the *Tariff Commission* consisting of six members. This commission was empowered to make recommendations for the enactment of scientifically devised tariffs. In 1932 the President was given the power by Congress to raise or lower the tariffs on some commodities without congressional action. Although this effort seems to have been in the right direction, the general opinion is that it did not work out satisfactorily.

What Are Reciprocal Trade Agreements? In 1934 Congress gave the President the power to raise or lower any tariff as much as 50 per cent and to enter into *reciprocal trade agreements* with other nations without action by Congress. In this way the President can agree to lower our tariff if another nation will lower its tariff. One of the purposes of this move was to stimulate our exports of farm products.

Trade agreements were entered into with Great Britain, Canada, Switzerland, France, South American countries, and others. By agreement the duties on certain kinds of articles imported from a country were reduced by the United States, while the other country reduced the duty on certain articles that we export to that country. For example, the United States reduced the duties on certain goods imported from France, including wines, perfumes, Roquefort cheese, lace, tinsel products, silks, and vanilla beans. In return, France reduced the duties on many kinds of goods imported from us. These goods included fresh apples, pears, canned salmon, radios, automobiles, tires, silk hosiery, typewriters, refrigerators, and others.

International Cartels Fix Prices and Limit Supply. An *international cartel* is a combination or arrangement between two

or more business concerns located in different countries for the purpose of conducting their affairs in such a way as to make more profit. In other words, the cartel is a monopolistic device for eliminating competition between the members of the organization.

For example, a cartel of an American and an English firm provides that the English firm will not attempt to sell patented chemical products in the United States, and the American concern will not sell its products in any part of the British Empire. Since the big English firm controls most of the chemical industries in the British Empire, the cartel serves to keep out of the United States practically all the chemical products made in Great Britain. Likewise, the cartel prevents the American concern from selling its products in any part of the British Empire. As you can see, a cartel is a form of monopoly. And cartels often have the same effects as a protective tariff.

In 1944 there were more than 175 known international cartels. More than 100 of these included American concerns that were engaged in selling manufactured, mineral, and agricultural products.

As a rule, international cartels are formed in one of three ways. One method is for concerns engaged in similar lines of business to agree to fix prices and limit the supply of goods. Another method is to form an agreement by which each concern limits its sales to certain countries and allows the other members of the cartel to use its patents. A third method is for the concerns to exchange portions of their shares of capital stock, so that the big stockholders and directors of the two or more concerns can control all the concerns as though they were all one corporation.

International cartels are very effective. For example, an American and German cartel before the war raised the price of tungsten carbide, used in making electric light bulbs, from $50 to $450 a pound. In another case the price of molding powder used by dentists was increased from 85 cents to $45 a pound. Because of their financial strength, these big cartels are able to stamp out or prevent competition.

There are some who claim that since international cartels tend to remove competition between competing concerns in

different countries, they encourage peaceful international relations. Most people, however, who understand how they work and who have no financial interest in them, are opposed to international cartels. The reasons why they oppose them are that they raise prices to consumers; they limit supplies of certain products; they result in inferior goods because of the absence of competition, all of which enable the combined concerns to make unreasonably high profits.

QUESTIONS ON THE CHAPTER

1. How does the law of comparative advantage explain the reason for trade?
2. How has a territorial division of labor been an advantage in the United States?
3. Why are there no taxes on interstate commerce?
4. What restrictions are there on interstate trade?
5. Why is there specialization in production among nations?
6. What are our chief imports and exports?
7. What, in general, is the purpose of a tariff on imports?
8. How does a tariff for revenue only differ from a tariff for protection?
9. State briefly the arguments for and against protection as they relate to each of the following: (a) nationalism, (b) the home market, (c) military necessity, (d) infant industries, (e) dumping, (f) the protection of labor, (g) equalization of the cost of production, and (h) governmental revenue.
10. What attempts have been made by Congress to regulate tariffs scientifically?
11. Illustrate how an international cartel operates.
12. What is the meaning of each of the following terms?

(a) **antiprotectionist**
(b) **dumping**
(c) **export**
(d) **foreign trade**
(e) **free trade**
(f) **import**
(g) **international cartel**
(h) **law of comparative advantage**
(i) **nationalism**
(j) **protectionist**
(k) **reciprocal trade agreement**
(l) **tariff**
(m) **Tariff Commission**

APPLICATIONS OF THE CHAPTER

1. How does the law of comparative advantage operate in a home?
2. Show how the law of comparative advantage operates in the United States. Name a state noted for cotton production; wheat growing; coal mining; hog raising; lumbering.
3. Name three nations that seem to have an abundance of natural resources and three that lack essential natural resources.
4. What evidence can you advance to prove that tariffs lead to wars?
5. How has the need for natural resources influenced international history during the past ten years?
6. What would happen to our national income if none of our cotton crop could be sold abroad?
7. What were the effects of our inability to obtain raw rubber from abroad in World War II?
8. Germany had tried to foster an intense spirit of nationalism. But in 1939 she entered into a trade agreement with Russia. Do these two facts seem contradictory?
9. What is the relation, if any, between freedom of trade between the states and the fact that the United States has become the greatest industrial and commercial nation in the world?
10. One of the leading steel manufacturers in the South is a descendant of one of the prominent political leaders who, before 1860, helped to oppose the policy of protection advocated by the political leaders of New England. This manufacturer is today very much in favor of a protective tariff on iron and steel. How does this fact tend to prove the statement sometimes made that tariffs are local not national issues?
11. The Doe and Green Manufacturing Company is engaged in manufacturing a product that could be produced much more cheaply in England than in this country. The product enjoys a high protective tariff at the present time. If the protection were removed suddenly, what would happen to the workers employed in the factory? to the capital invested in the factory? to the people who use the product? Would there be any difference if the tariff were lowered gradually?
12. It has been said that, if a country once adopts a policy of protection, it can never abandon that policy without doing someone an injustice. Discuss this statement.
13. A protective tariff on sugar helps the sugar growers in Louisiana but makes the cost of sugar greater to the consumers. A protective tariff on wool helps the sheep growers in Montana but results in higher prices of woolen clothes. What are the arguments for maintaining protection in these cases?

14. During and after World War I we lent billions of dollars to the nations that were opposed to Germany. These nations did not have enough gold with which to repay the amount owed us, and could not get it. In what other way could they have paid us? What effect would such a method of payment have had on our manufacturers? on our wage earners? on consumers? If the war debts were canceled, who would have to pay them? (Keep in mind that the money and the credit lent to European nations were borrowed from our own people and that those who now own Government bonds will have to be paid at some time.) What relation, if any, does the tariff have to war debts?
15. If it is undesirable for the various states in this country to levy tariffs on goods imported from the other states, why should we impose tariffs on goods imported from Canada? Give practical reasons for your answer.
16. Is the United States becoming more independent of other nations, or is it becoming more dependent on them? Give definite reasons for your opinion.
17. To what does the expression *foreign trade* refer? Does it mean the trade between nations or between individuals and concerns in different countries?
18. If all our exports were stopped suddenly, which of the following would be most affected: American cotton mills, cotton growers, corn growers, consumers of cotton goods, automobile manufacturers, bankers? Give reasons for your answer.
19. How did the war affect our foreign trade?

TOPICS FOR SPECIAL REPORTS

1. Tariff history from 1920 to the present.
2. The tariff as a political issue.
3. Infant industries in the United States.
4. Reciprocal trade agreements.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Are protective tariffs a cause of war?
2. Should the United States attempt to become as self-sustaining as possible?
3. Has our policy of protection enabled this nation to attain a high degree of prosperity?
4. Do international cartels promote world peace?

UNIT IV

Prices

The prices we pay for goods and services, and how those prices are determined by competition, monopoly, and government.

Prices

CHAPTER 12

VALUE AND PRICES

We are daily concerned with prices. The milkman and the grocer deliver their goods only for a price. When we enter a store, we may inspect the goods; but unless we agree to pay the price asked, we may not take any of the merchandise with us when we leave.

The wage earner and the businessman, too, are interested in prices. The amount of goods and services that the wage earner can buy depends upon how much he receives for his labor and upon the prices of the things he buys. The businessman is interested in making a profit. And the only way he can make a profit is to sell goods at a price that is higher than their cost.

In fact, from the beginning of life to the end, we are confronted with the problems that arise in connection with prices.

Price and Value Are Related. Before a thing can have a price, it must have value. The term "value," however, is so broad that we must limit its meaning in order to show the relation between value and price. For example, we may properly speak of the value of friendship, of certain memories, or of religion. But we seldom think of prices in connection with these things. We esteem them, but ordinarily we do not set a price on them in terms of money.

But consider a loaf of bread or a pair of shoes. Like the things mentioned above, we say that they have value. But, unlike friendship, memories, and religion, they usually can be obtained only in exchange for money or something else that has value.

Thus, the term value may be used to indicate esteem for things, both tangible and intangible, and for those that may be obtained without cost, as well as those that must be purchased. But here we are concerned only with the latter use—value as it pertains to economic goods and services.

Value Differs with Individuals and Circumstances. Value is not a quality that resides in an object, like hardness or color. The value of anything depends upon the person doing the valuing and upon the circumstances. For example, you might place a high value on a new football, while an old person would probably be willing to give very little for it, especially for his own use. Or if you were very thirsty, you might be willing to pay a considerable amount for a cold drink; but if you were not thirsty, you would pay nothing for it.

Is It True That the More You Have the Less You Want? Individuals in modern society want many things that people in former times probably never dreamed about. You use many kinds of articles that were unknown to your great-grandfather. The kinds of clothing, food, transportation, communication, equipment for the home, and so on have increased in number since the dawn of civilization. As we have become accustomed to the use of these new kinds of goods, our desires for them have grown. And inventors are still trying to devise new kinds of articles that will meet our desires for additional types of services. Therefore it seems that there is no limit to the possible expansion of the number of our wants.

At the same time many, if not most, of our wants may be satisfied temporarily. However hungry we may be, our desire for food can be fully satisfied for a time, although we shall again become hungry. When you are extremely thirsty, it may seem that you could drink innumerable bottles of soda water. But, as you know, your desire for another bottle of soda water greatly decreases by the time you have drunk one.

Experiences such as these illustrate a very important principle that affects the use of goods. This principle is known as the *law of diminishing utility*, which may be stated as follows: The intensity of our desire for additional units of a good decreases as our supply of that good increases.

It may be that you are inclined to question this statement. You may say that often the more one has the more he wants. For example, you could point out that the more one reads good literature, the more he likes to read; or that the more luxuries one has, the more luxuries he wants. Likewise you could say

that the craving for intoxicants and drugs increase as the victim uses these things. And no one could successfully disagree with you. But the law of diminishing utility is a statement of what is true at a given time. It is true that at a given time, for example, one's desire to read a good book can be satisfied.

The Utility of a Unit of a Good Depends upon One's Supply. Like most people, you are probably fond of apples. Therefore if you have only one, you are likely to eat it yourself. If, however, you happen to have a large supply of apples, you may feel more generous and give some to your friends.

Your willingness to give your friends some of your apples when you have a large supply is not unusual, but it illustrates a very important fact. This is the fact that the larger our supply of a good at a given time, the less a unit of the good means to us then. That is to say, when our supply is large, the utility of a unit is less than when the supply is smaller.

The utility of a unit of a good, where the units are alike, at a given time is the *marginal utility* of the good to an individual at the time. We can think of the utility of a unit in either of two ways. We may think of the utility of a unit of the goods in our stock or supply; or we may think of the utility of an additional unit. In either case, we would not think of a particular unit, since all the units are alike. That is the reason why it is sometimes said that marginal utility is the utility of one more or one less unit. Marginal utility increases as the supply of goods becomes smaller and decreases as the supply becomes larger.

Burgert Bros.

Picking Oranges

If you had one of these boxes of oranges, would the marginal utility of an orange to you be relatively high or low?

The Unit Prices of Commodities Do Not Indicate the Total Usefulness of Goods. For example, the total utility and usefulness of bread is much greater than that of diamonds. Perhaps the world would not suffer greatly if all the diamonds were destroyed. But the loss of bread would be inestimable. A famous baseball player may be able to earn many thousands of dollars a year, while an unskilled laborer may receive only a few hundred dollars a year for doing heavy manual labor. The reason is that the services of the ball player have high marginal utility to the managers of ball leagues. The marginal utility of unskilled laborers to employers is low because of the ease with which ordinary labor may be obtained. As far as society is concerned, common labor, on the whole, is more valuable than baseball skill and activities.

Subjective Value Is Value in Use. We see, therefore, that we individually place values upon goods because they have utility and are scarce. When thinking of what a pencil means to him, a person considers two things: (1) the utility of the pencil as a writing instrument and (2) the amount of satisfaction that the use of the pencil will give him. In other words, the value that exists in connection with the pencil is in an individual's mind and is related to the use of the pencil in satisfying his need for a writing tool. Value in this sense is called *subjective value*, or *value in use*.

The object of a manufacturer or a dealer who buys materials or goods is to sell them at a profit. He does not intend to consume them himself. Nevertheless he values the things he buys because of the purpose for which they will be used. The things bought have utility to the buyer because he feels that they can be used to satisfy his desire to make a profit.

Exchange Value Is Trading Value. Before goods can be exchanged, the parties to the transaction must estimate the amount of satisfaction that can be derived from the goods to be exchanged. Suppose, for example, that on a hot day you have two ice-cream cones and I have two glasses of lemonade. Perhaps each of us would rather have one ice-cream cone and one glass of lemonade than two of either. The reason is that the

marginal utility is less when we have two units than when we have only one.

Before we decide to exchange articles, therefore, we attempt to estimate the marginal utility of one good in terms of the marginal utility of the other good. In such a case value is expressed in terms of objects or goods. For example, you may say that you would rather have one of my glasses of lemonade than one of your two ice-cream cones. Thus, by comparing the utility of one of the cones that you have with the utility of one of the glasses of lemonade that I have, you decide which has the more value for you. A comparison of marginal utilities takes place in every exchange of goods or services in trade. Value, when used in this sense, is called *exchange value*.

Price Is Exchange Value Stated in Terms of Money. Of course, we do not customarily use *barter*—exchange one good for another—as a means of exchange. We use money as a medium of exchange. In valuing things, we do not ordinarily value them in terms of other goods, but in terms of money. For this reason it may be said that *price* is the exchange value of a unit of an article expressed in terms of money.

The purpose of the discussion in this chapter up to this point has been to show that exchange value arises because of the utility of goods and that price is a convenient way of saying what the exchange value of a unit of a particular good is.

What Is Market Price? By *market price* we mean the price at which goods are actually bought and sold. Sometimes the term *competitive price* is used to convey the same meaning, because in the case of most market prices there are many buyers and more than one seller. If the price is really competitive, however, each of the sellers tries to sell at as high a price as he can in order to make the greatest amount of total profit, and each of the buyers endeavors to purchase at the lowest possible price. Such a condition would be a case of perfectly free or pure competition.

As we shall see in the next chapter, only a few prices are determined by perfect competition. But in the remainder of this chapter we shall consider how prices result when there are a great many buyers and sellers.

Market Prices Result from Demand and Supply. Practically everyone knows that demand and supply have something to do with prices. Moreover the prices of things affect demand and supply. For example, in the winter months, if the supply of coal is small, the price will tend to be high. But if the price is high, the supply will tend to increase and the demand will tend to decrease. We are thus reminded of the question, Which comes first, the hen or the egg? Let us see if we can get a clearer understanding of how demand, supply, and prices are related.

Demand. For our present purpose, we mean by *demand* the quantities of a good that will be bought in the market at different prices. We must not confuse demand with mere desire or need for a good. One may need or desire a loaf of bread or a suit of clothes, but if he has no money, he cannot buy it. His desire, without the means of obtaining the things he wants, would have no influence on market price.

What is meant by a decrease in the demand for wheat or cotton or any other product, as indicated by a fall in price, is that relatively fewer people are able and willing to pay the price at which the good formerly sold. It does not necessarily mean that people have less need for the good.

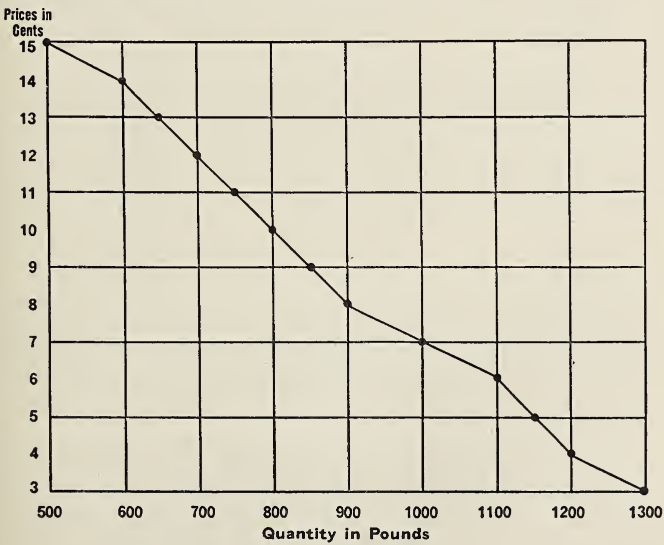
Utility and Demand. In all cases goods are desired because the prospective purchasers believe that the goods possess utilities that will enable them to satisfy wants. This is the only reason why people buy goods. A person wants goods either for the purpose of consuming their utilities or for the purpose of making a profit by reselling them. In either case the intention is to use the goods for the purpose of obtaining satisfaction and pleasure in some way.

The Relation Between the Market Price and Demand. In order to illustrate the relation between the market price and demand, let us take the following assumed example, keeping in mind that it is used only for the purpose of illustration.

Suppose that in a certain community the quantities of sugar that would be bought at different prices are as follows:

PRICE OF A POUND	NUMBER OF POUNDS THAT WOULD BE BOUGHT AT THE PRICE INDICATED
15c.	500
14c.	600
13c.	650
12c.	700
11c.	750
10c.	800
9c.	850
8c.	900
7c.	1,000
6c.	1,100
5c.	1,150
4c.	1,200
3c.	1,300

Let us now show graphically the relation between the price of sugar and the quantity that would be purchased at that price. In order to do this, we shall take a piece of graph paper and say that vertically the spaces represent the prices listed above and that horizontally the spaces represent the quantities of sugar that would be bought at the prices indicated.



Demand Curve

Then we place a dot at the point where the line representing 3 cents and that representing 1,300 pounds meet. We do the same for 4 cents and 1,200 pounds and for each of the other prices and quantities. We then connect the dots with a line.

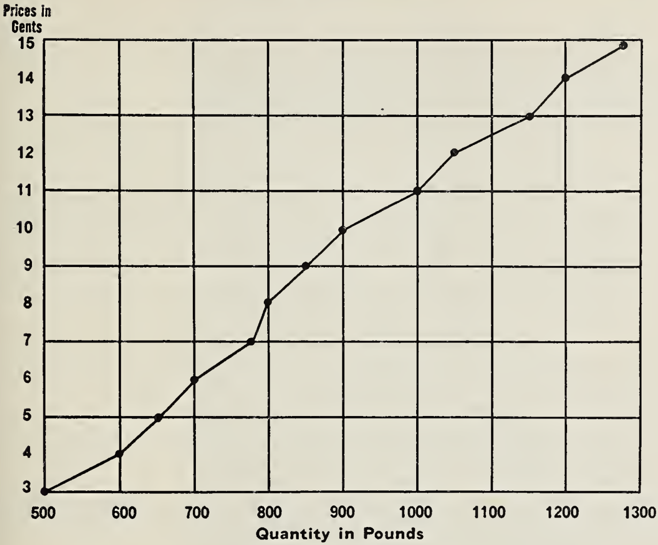
After we have done this, it is evident that the line connecting the dots describes a downward curve to the right. This line represents the tendency for people to buy more sugar when the price is low than when it is high. The fact that people do ordinarily buy more when prices are low (if their purchasing power does not decrease) and less when prices are high is well known. Hence we are safe in using the above type of figures and graph to illustrate the relation of demand and price.

Supply. *Supply* is the total quantity of a good that will be offered for sale at a specific price. In order to show the relation between supply and price, let us continue our consideration of sugar prices. We may say that the following quantities of sugar would be offered for sale at the prices indicated.

Price of a Pound	Number of Pounds That Would Be Offered for Sale
3c.	500
4c.	600
5c.	650
6c.	700
7c.	775
8c.	800
9c.	850
10c.	900
11c.	1,000
12c.	1,050
13c.	1,150
14c.	1,200
15c.	1,280

By the use of a graph we can show the relation of price to the supply of sugar. As in the case of the previous graph, let us say that vertically the spaces represent the prices listed in the above table, and that horizontally they represent the quantities shown in the table.

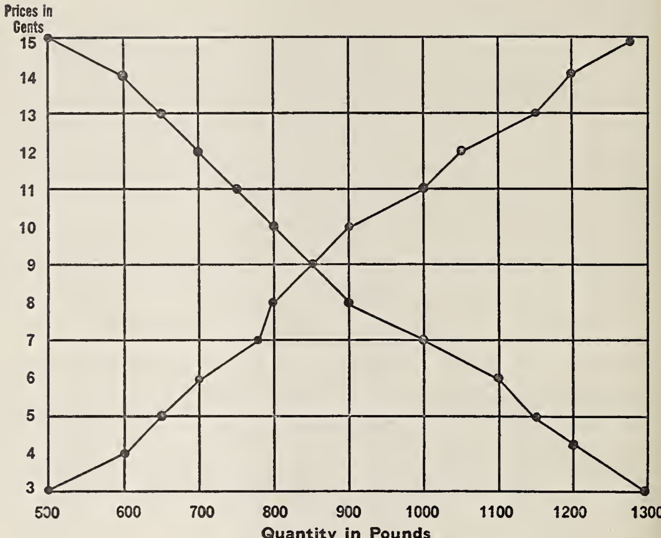
We then place dots at points opposite the prices and the corresponding quantities. For instance, we place a dot opposite 3 cents and 500 pounds. Then we connect the dots with a line. This line, which rises from left to right, indicates the tendency for the supply of sugar to increase as the price increases.



Supply Curve

The Equilibrium of Demand and Supply. By combining the supply curve with the demand curve, we get the graph shown at the top of page 186. The point where the demand and the supply curve cross indicates what would be the market price under the assumed conditions. At this point demand is equal to supply; the price would necessarily be 9 cents; and demand and supply are in balance.

We may explain as follows why it can be said that demand and supply are equal at the point of intersection and that the price would be 9 cents. As we know, buyers of sugar will pay no more than they have to pay and sellers will take no less than they are forced to take. Therefore, if the demand for and the supply of sugar are what they are represented to be in the tables and graphs referred to above, the market price would be 9 cents a pound. If buyers will take no more than 850 pounds at 9 cents a pound, only that number of pounds will be offered for sale at 9 cents a pound. If enough buyers were willing to pay 10 cents a pound, 900 pounds would be offered, but each



Demand and Supply Curves

one of the buyers would have to pay the higher price. If buyers were not willing to pay the higher price, the supply available for sale would be less than 900 pounds.

Present and Estimated Future Prices Affect Supply. The present supply of any good is largely the result of past estimates as to what the present price would be. Hence, the quantities of wheat, cotton, and shoes that will be offered for sale next year depend, in a large measure, upon what producers now think prices will be then.

If cotton farmers, for example, believe that the prices for next year will be higher than at present, they will, on the whole, spend more money for labor, fertilizer, and machinery and will endeavor to produce more cotton than they would if they believed the prices would be lower. A few farmers may feel that if prices will be higher then, they will not need to raise so much cotton as before. But this would be an exception to the way in which estimated future prices usually affect production.

Picking Cotton

What effect does a change in prices for textiles have upon cotton production and supply?

U. S. Department of Agriculture

Likewise, manufacturers enlarge their plants and buy new equipment and more materials when they feel reasonably sure that the prices of their products will increase. On the other hand, when lower prices are in prospect, manufacturers often curtail production. The tendency for producers to be guided by prices is in keeping with a fundamental principle of capitalism.

If the price of cotton is 8 cents, but for next year it is estimated that it will be 15 cents a pound, cotton producers will tend to invest in labor and capital for the production of cotton as long as it seems that it will be profitable for them to do so. Many, perhaps, will invest so heavily in labor and capital that their cost of production will exceed the amount that they will receive for their cotton, even if the price should be 15 cents. In practically every line of production there are those whose costs of production or expenses of carrying on their businesses are more than the income they receive for what they sell. This is true of many farmers, manufacturers, merchants, and others engaged in business and industry.

Producers of all kinds whose cost of production exactly equals the amount that they receive for their product are called *marginal producers*. Those whose cost of production exceeds the amount that they get for their product are *sub-marginal producers*.

Demand May Be Elastic or Inelastic. In some cases a slight change in price will result in a marked change in the demand for an article. In other cases even a considerable change in price will have a comparatively slight effect on the amount that the public will buy. For example, a slight increase in price will cause families to buy considerably less butter. On the other hand, even a marked change in price would not affect greatly the amount of salt that people will buy.

The way a change in price affects the amount of an article that people will buy is referred to as the *elasticity of demand.* When a change in price results in a considerable change in the quantity of a good that people will buy, demand is said to be elastic. When a change in price has no, or only a little, effect on the quantity that will be bought, the demand is inelastic.

It is sometimes said that the demand for necessities is inelastic, while the demand for luxuries is elastic. In many instances, however, this idea may be misleading. For example, cigarettes are often classified as a luxury, and so is fine clothing. On the other hand, food is considered a necessity. Yet the demand for cigarettes is relatively inelastic, and it is frequently said that shop girls will go without sufficient food in order to buy clothes. In other words, what is a necessity and what is a luxury depends upon the attitude and the opinion of the individual. For that reason it would seem more nearly accurate to say that a necessity is an article or a service for which there is an inelastic demand and that a luxury is something for which there is an elastic demand.

Where it is possible to find a substitute for an article, the demand for the article is likely to be elastic. For this reason the demand for a particular kind of an article is more elastic than is the demand for a class of goods. For example, the demand for butter is fairly elastic, because if the price goes too high, people will buy substitutes for butter. Likewise, if the price of one

kind of cigarettes goes up, users will switch to other brands; but the total number of cigarettes consumed will remain about the same.

In this connection it is interesting to observe that the lowering of the cost of production may cause a luxury to become an article of everyday use. For example, less than one hundred years ago bathtubs were so unusual and expensive that they were considered a luxury. Less than a quarter of a century ago an automobile was a luxury for most people. But as mass production resulted in a decrease in the prices of these goods, each is now considered a necessity for a large number of the population. Increased efficiency in production, when followed by lower prices, results in the use of a greater variety of goods by more of the people. After they have become accustomed to use the goods, things that were once looked upon as luxuries come to be regarded as necessities.

Supply Also May Be Elastic or Inelastic. The degree to which changes in price affect the quantity offered for sale is known as the *elasticity of supply*. If a slight change in market price for a commodity results in a considerable increase in the supply, the supply is elastic. If changes in price have comparatively little effect on the supply that is offered for sale, the supply is inelastic.

Often a considerable time is required for a change in price to have any effect on the total supply of a commodity. This is due to the fact that much production is a roundabout process or that it is seasonal. In the case of a shortage of potatoes, due to a poor crop year, a year must elapse before an increased supply can be offered. However, when factories have been built or farms increased in number and size, so as to produce an average supply, and the demand falls, it is often difficult to adjust the supply to demand. For example, during World War I, when the price of wheat was high, more land was brought into cultivation and more farmers went into the business of growing wheat. When the war ended and many soldiers went back to farming in the various wheat-growing nations of the world, and as improved methods of production were introduced, the price of wheat fell. Our wheat farmers found it difficult, however, to

reduce the amount of wheat produced. They had invested in machinery and livestock, and many had built houses and barns with the idea of producing this crop. There was little for them to do other than to raise wheat. These examples illustrate the fact that often some time is required for a change in price to result in a change in the supply of an article. Even over a long period of time, however, the supply of some articles is more elastic than is the supply of other articles.

Enterprisers Adjust Supply to Demand. It is the function of enterprisers to adjust supply to demand. To the extent that the capital of the country is invested so as to supply the quantities of goods and services needed, the welfare of the people is increased. This means that the right proportion of the capital of the nation should be invested in each industry. If too much is invested in farms, too much of agricultural commodities will be produced to enable farmers to make a profit. If too much capital is invested in coal mines, there will be more coal miners than can be profitably employed all the time. And so it is in the case of each industry.

Under our system of economic order it is believed that the business judgment of individual investors will result in a balanced investment of the national capital. The judgment of private owners of capital is relied upon to anticipate the future needs of the people for goods and services. Under a system of planned economy governmental officials attempt to direct the flow of capital into what is believed to be the proper channels. Here is one of the essential differences between capitalism and a planned economy, such as socialism or Fascism.

QUESTIONS ON THE CHAPTER

1. Give examples to show why prices are important.
2. Do value and price mean the same thing?
3. Why is the value of a thing not the same to all persons?
4. Give an example to show what is meant by the law of diminishing utility.
5. What is the relationship between marginal utility and the law of diminishing utility?
6. If you have a number of pencils, is the service that one pencil gives any different from the service that the pencil would give if you had only one? Is the utility greater or less?

7. How does the number of pencils you own affect the value that you place on only one of them?
8. Explain the difference between "value in use" and "exchange value." When is each more important?
9. What is the relationship between price and exchange value?
10. When can market price be identified as competitive price?
11. How are demand, supply, and market price related?
12. How does demand for a product differ from desire or need for it?
13. Explain how, under competition, demand and supply determine prices.
14. In a graph of the demand and supply for a particular product at different prices per unit, what does the point of intersection of the two lines represent? Why?
15. How do future prices affect the supply of goods?
16. Who are marginal producers? Submarginal producers?
17. Give examples to indicate what is meant by elastic demand and inelastic demand.
18. Give examples to indicate what is meant by elastic supply and inelastic supply.
19. In a capitalistic system who adjusts supply to demand?
20. What is the meaning of each of the following terms?

    (a) **barter**
    (b) **competitive price**
    (c) **demand**
    (d) **elasticity of demand**
    (e) **elasticity of supply**
    (f) **exchange value**
    (g) **law of diminishing utility**
    (h) **marginal producer**
    (i) **marginal utility**
    (j) **market price**
    (k) **price**
    (l) **subjective value**
    (m) **submarginal producer**
    (n) **supply**

APPLICATIONS OF THE CHAPTER

1. Report on some current problem connected with prices. Discuss it in the light of the principles developed in this chapter.
2. Recall an instance in which you were undecided as to which of two things to buy. Which one did you finally buy? What determined your choice? What part did values play in your decision? In what way was price involved?
3. (a) It has been said that price is an attempt to state the value of a commodity or a service in terms of money. What does this statement mean?

   (b) Is value a constant thing? Why will one person pay ten dollars for a hat or a fountain pen, while another will not? Under what conditions is the price of a commodity indicative of the value of the commodity?

4. Using a sheet of graph paper, construct a graph showing the market price of a commodity when the conditions of demand and supply are as follows:

Units That Will Be Purchased	Price of a Unit	Units That Will Be Supplied
100	$1.50	325
110	1.40	295
120	1.30	290
135	1.20	275
150	1.10	245
165	1.00	200
185	.90	160
200	.80	125
225	.70	120
255	.60	90

5. Would you consider the demand represented by the graph elastic or inelastic?
6. Discuss the elasticity of demand in connection with the following commodities: shoes, bread, water, flowers, perfume. Account for the differences in elasticity.
7. Show how the present supply of all kinds of goods resulted from prices estimated in the past.
8. It has been stated that, if only a comparatively small part of the total supply of a commodity (for instance, cotton or wheat) is produced by submarginal producers, the market price will be materially lower than it would be if there were no submarginal producers. What do you think?
9. Enumerate the causes that result in an increased demand for the following goods: automobiles, motion-picture theater tickets, grand-opera tickets, canned goods, soap, toothbrushes, good houses, high-class magazines.
10. Why does the price of an article in the United States tend to be the same in all parts of the country?
11. Report on the production of one of the following commodities in various countries: wheat, cotton, cattle, automobiles, electric-light bulbs, fertilizers, any other product in which you may be interested. What effect does the production of a commodity in a foreign country have on prices in this country? How does this affect the standard of living of our people? Which classes or groups are affected?
12. It has been said that competition is the life of trade. Explain the meaning of the statement in terms of demand and supply.
13. Distinguish between a luxury and a necessity. What are the bases for your answer? Is the demand for luxuries more elastic than that for necessities? Why? What would be the effect of a five per cent sales tax on diamonds? on salt?
14. Suppose that it would cost $1,000,000 to build a mound 500 feet high in a desert. Would the mound be worth that amount

to you? Again, suppose that it cost an artist several days' work and $5 worth of materials to paint a picture that he sells for $1,000. From these assumptions discuss the relations between the cost of production, the value, and the price.

15. What are the relations between current costs of production and future supplies of goods? between current costs of production and present prices?
16. What interests do consumers have in inventions that decrease the costs of producing goods? Can you see any relation between your answer and the fact that society, by means of laws, gives inventors the exclusive right to use their inventions for the purpose of making a profit?
17. Give an example where the demand for an article is elastic; one where the demand is inelastic. Give reasons to explain each.
18. Give examples of elastic supply; of inelastic supply. Explain each.

TOPICS FOR SPECIAL REPORTS

1. The advantages and the disadvantages of "loss leaders." (A loss leader is an article sold by a merchant at cost or below cost or at least at less than the customary price.)
2. The importance of marginal utility to the merchant and to the consumer.
3. The factors in the demand for, and the supply of, a selected commodity. (For example, diamonds, gold, automobiles, adequate school buildings, comfortable residences, evening gowns, silverware, cosmetics, good books, good roads, parks, or the like.)
4. Why the prices of particular commodities tend to decrease.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Do most people buy at the lowest possible prices?
2. Is supply adjusted to demand better under a system of capitalism than under a system of a planned economy?

CHAPTER 13

COMPETITION AND MONOPOLY

During the Middle Ages churchmen and scholars believed that nothing should sell for more than it was worth. The price at which a thing should sell was said to be its *just price*. Exactly what this price was in terms of money was not easy to determine. But, in general, it was held that a just price was equal to the cost of the materials and the labor used in making it. Since little capital was used in production, the cost of capital was not considered.

Prices Are Determined in Different Ways. In modern times it is generally recognized that price is not a simple matter. For a long time—say, about the first hundred years of our national history—it was thought by most people that prices in general should be determined by competition; that is, if anyone was free to engage in business, there would be a number of producers. Since each producer would be eager to make as much profit as possible, he would try to sell all the goods he could. And in order to do this, he would endeavor to sell at a lower price than his competitors. As a result, it was thought, prices would be fair and reasonable.

About sixty years ago the first important laws were passed by Congress giving the Government the power to regulate certain kinds of business in order that the prices of certain commodities and services would remain reasonable. One of these laws was the Interstate Commerce Act (1887) and another was the Sherman Antitrust Act (1890). The former was to provide regulation of railroad rates, and the latter to prevent business combinations that would enable them to charge exorbitant prices. Since the passage of these laws, we have had other laws for the regulation of business.

At the present time the most important factors that influence the prices of the goods we buy are: (1) competition;

Blast Furnaces in Operation at Night

In times of prosperity, prices tend to rise, resulting in increased production and supplies of goods.

U. S. Steel Corporation

(2) monopoly; (3) monopolistic, or imperfect, competition; and (4) government regulation. In this chapter we shall consider further the subject of competition; then we shall study monopoly and imperfect competition. One of the phases of government regulation of prices will be considered in the next chapter.

Competition Results in a Normal Price. By *normal price* we mean the price of an article that tends to prevail in the long run. The "long run" usually implies a period of time extending over a number of years, and, in some cases, a number of decades. At any time the market price may be high or low; it may be above or below normal price. A rise in price may be due to a temporary decrease in supply or an increase in demand. But an increase in price is very likely to tempt additional producers to undertake production. And when they do, there is an increase in supply, and the price falls, unless there is a corresponding decrease in demand. A decline in price will eventually result in a decrease in supply, which will tend to cause the price to rise again. So we see that, as long as there is free competition—where there are a great number of both producers and consumers of a product, and where it is easy for producers to enter or to leave a field of production—the market price does not come to rest at a certain level.

The fluctuations in market prices, when prices are determined by competition, may be compared to the waves on the

ocean. At times the crest of a wave rises above the surface, or normal level, of the ocean, and the wave is followed by a depression, the trough of which may be considerably below the normal level of the ocean. But the force of gravity causes the wave to subside, and the pressure of the water, caused by gravity, causes the depression to fill up. While there is a constant tendency for the water to come to rest at its normal level, the equilibrium of the ocean is constantly being upset by the wind and the attraction of the moon.

Economists say that normal price coincides with that price which is just high enough to cover the costs of production of marginal producers after the forces of demand and supply have had time to become pretty well adjusted to each other. By marginal producer is meant a producer who only "breaks even" and does not make any profit. His cost of production is as much as he receives from the sale of his product. It is said that if the price is higher than this, other producers will enter the field, and prices will fall. And if the price is lower, producers who operate at a loss will cease production, which will result in a reduced supply and in a rise in prices.

The idea of normal price is of value to us in that it enables us to see that under conditions of competition the price of a good tends to be determined by costs of production and conditions that cannot be controlled by one or even a few producers.

Monopoly Is a Method of Price Determination. *Monopoly* is the power to control. As it concerns price, it means the power to fix the price of a product or a service by arbitrary methods, such as by controlling the supply. The prices of many of the things we use are fixed by either partial or total monopoly.

There Are Two Classes of Monopolies. In general, monopolies are (1) public and (2) private. *Public monopolies* embrace certain economic undertakings carried on by the government, such as streets, roads, and gas and electric facilities owned by the city. *Private monopolies* are those held by private concerns and individuals. As you will see in the following chapter, public utilities, which are a form of private monopoly, are regulated and controlled by government agencies.

Private Monopolies Originate in Different Ways. There are several ways in which private monopolies originate. For convenience we may consider private monopolies as arising from (1) the possession of superior skill or talent, (2) the granting of a privilege by the government, or (3) the ownership of capital.

Monopoly Due to Superior Skill or Talent. In the theatrical field those who possess great ability are few. Few musicians have the superior talent that enables them to command great sums of money for their performances. In other fields in which special skill or ability is scarce, the fortunate possessors of such skill or ability often receive great rewards. Absence of competition creates a monopoly for those who are especially endowed. Competition is almost as effectively forestalled as if others were prevented by law from entering the field.

Monopoly Due to a Privilege. Many private monopolies originate in the granting of a privilege by a government. Such a privilege may be in the form of a franchise, a copyright, or a patent. A *franchise* confers the right to engage in a particular enterprise, such as the construction and the operation of a street railway, an electric-light system, or a water system.

A franchise is granted because, from the point of view of society, it is better to restrict the production of a particular service to one producer or, at the most, to a limited number. For example, it is evident that in most instances there should be only one streetcar system in a community, and it is usually considered best for only one telephone system to be operated in a city.

A *copyright* gives an author the exclusive right to publish his literary production for a period of twenty-eight years, with the privilege of renewing the copyright for a similar period. An inventor may obtain from the United States Patent Office a *patent*, which will give him the right to make, use, and sell his invention for a period of seventeen years. Monopolies in the forms of copyrights and patents are granted because it is thought that they will tend to stimulate the production of literature and the development of inventions and thus to benefit society in general.

Monopoly Due to the Ownership of Capital. As we have said before, modern production is carried on largely by the use of capital. Comparatively few people are free to embark upon any business enterprise that they might desire to undertake. In many lines of production the "little man" is finding it increasingly difficult to compete with large-scale enterprises. Not all business is being taken over by large corporations. Still, in certain fields the tendency is toward large-scale methods in the production and the distribution of goods.

In some instances the necessity for a great deal of capital makes it practically impossible for more than a few producers to compete in a given field. For example, in the steel industry two concerns manufacture more than half of all the steel produced in the United States. In the automobile industry there are only a few concerns that manufacture automobiles. Mammoth department stores are often able to undersell smaller concerns. This is due to the fact that the larger stores can buy goods in huge quantities and thereby can obtain them at low prices, and to the fact that they are sometimes able to reduce the expenses of selling an article as compared with the expenses of the smaller concerns.

It is evident that the possession of capital may, in a very real sense, give one company a partial, if not a total, monopoly. While other individuals or concerns may not be restricted legally from entering the field, they are prevented from doing so by a lack of capital.

The Monopolist Aims to Make a Large Profit. From a business point of view the primary aim of the monopolist is to make as large a profit as possible. Regardless of whether he acquires his monopoly through a franchise or as the result of his control over a large amount of capital, his intention is to obtain the greatest amount of net profit from the operation of the business. This truth is pretty generally understood by the public, but conclusions as to what it means to consumers are not always sound.

Most people are probably of the opinion that, when the monopolist is free to fix the price, monopoly always means the highest price at which goods can be sold. Perhaps the ex-

periences of the public with some monopolies have been sufficient to justify this belief. At the same time it is well to know that monopoly does not necessarily mean the highest possible price. Besides the present profits the monopolist will, if he is intelligent, consider other factors. One of the most important of these factors is his cost of production.

Cost of Production Affects Monopoly Price. From the standpoint of production the monopolist is concerned primarily with the total net profit that he can derive from his business. As we can see, therefore, whether he restricts or increases his output depends, to some extent, upon which policy will likely increase his profits. In all cases his profits are determined by the difference between the total cost of production and the total income from sales.

In the production of any manufactured commodity the costs of production may be divided into two classes: (1) fixed costs and (2) variable costs. The *fixed costs* are those that are not greatly influenced by the number of units produced. They are more or less constant, regardless of whether a large or a small quantity of goods is turned out. For example, up to a certain point, the cost of the upkeep of a factory may not vary greatly when the quantity of goods produced increases. Costs that are fixed also include such items as managerial salaries and interest on long-time loans.

Variable costs are those that vary with the number of units of the commodity produced. These costs include the wages paid for direct labor, or labor used directly in making the product; the cost of raw materials; and any other expenses that are larger when a greater quantity of goods is made and less when a smaller quantity is produced. Hence, these costs vary with production. For example, the cost of the leather in 100 pairs of shoes is approximately 100 times as much as the cost of that in one pair.

Sometimes a producer is able to lower unit costs by increasing the number of units produced. Under some circumstances, increased production results in higher unit cost. It all depends upon how well balanced are the amounts of labor and capital that are in use by the employer at the time.

Competitive Prices Are Usually Lower Than Monopoly Prices. Since the making of profits is the primary aim in production, the monopolist is inclined to produce that quantity which will yield him the greatest amount of profit. If the production and the sale of a smaller number of units will bring him a larger profit than that of a larger number, he will produce the smaller number. Where competition prevails, one producer cannot limit the total supply, and the supply of an article is usually larger than when the article is produced by a monopolist. Hence, the price is likely to be lower.

The table below shows how the factor of costs may help to determine the quantity produced and the price charged by a monopolist. Let us assume that the figures are those of the Exclusive Company, which has a monopoly in the production and the sale of a machine for sharpening pencils.

(1) Price per Machine	(2) Number of Machines Sold	(3) Income from Number Sold	(4) Variable Costs per Unit	(5) Total Fixed Costs	(6) Total Costs	(7) Profit
$4.00	10,000	$40,000	$1.50	$20,000	$35,000	$5,000
3.50	12,500	43,750	1.50	20,000	38,750	5,000
3.00	17,500	52,500	1.50	20,000	46,250	6,250
2.50	27,500	68,750	1.50	20,000	61,250	7,500
2.25	35,000	78,750	1.50	20,000	72,500	6,250
2.00	40,000	80,000	1.50	20,000	80,000	0

NOTES: Column 3. The income in each case is the product of the price per machine (Column 1) and the number of machines sold (Column 2).

Column 6. The total costs in each case are the sum of the total variable costs (Column 4 multiplied by Column 2) and the total fixed costs (Column 5).

Column 7. The profit is the difference between the income from the number of units sold (Column 3) and the total costs (Column 6).

Under the assumed conditions the price of $2.50 a machine would yield the greatest amount of net profit. The monopolist would therefore naturally desire to fix the price at that figure.

Other Factors Concern the Monopolist. If only the cost of production were involved, the monopolist would, in most cases, limit the supply and charge the price for his commodity that would bring him the greatest amount of net profit at the time. But other factors may prevent him from exercising his power with regard to supply and price.

The Uncertainty of Demand. In the first place it is perhaps impossible for the monopolist to predict exactly what the demand would be if the price were lowered. Of course, he can raise and lower the price and thus, by a trial-and-error method, ascertain approximately the price that is most profitable. But in any case it is very difficult to fix exactly the most profitable price.

The Possibilities of Substitutes. Fear that the public will choose a substitute for his commodity may deter the monopolist from fixing the price as high as he might. For most goods there are usually substitutes, to which people will turn if the price is too high.

Possible Competition. Another factor that may prevent the monopolist from placing too high a price upon his product is fear of the development of competition. If the monopoly is not protected by law and is merely founded upon the ownership of a large amount of capital, there is always danger of arousing competition. If a concern is making large profits, others will be encouraged to enter the same kind of business.

The Fear of Public Control. The fear of interference by the Government may be sufficient to prevent a monopolist from fixing his price too high. Not only may the Government step in and regulate prices, but it may also go so far as to take over the industry entirely and to operate it as a governmental enterprise.

There Are Not Many Cases of Perfect Competition or of Pure Monopoly. When there is more than one producer of a class of goods, it is popularly supposed that competition fixes the price. And in such a case there is likely to be some degree of competition between the sellers as to prices. But competition will not be perfect.

At this point it may be helpful to summarize the conditions that must exist if perfect competition is to prevail. We may say that where perfect competition determines the price of an article, the following conditions exist:

(1) Buyers and sellers are sufficiently numerous that the amount that one buys or another sells has no immediate and

perceptible effect on the price at the time. This condition is fulfilled in the case of the sale of the products of some kinds of farmers, because no one farmer alone produces and sells enough of a product to have any appreciable effect on the total supply. Also there are usually a number of buyers of such products as wheat or cotton, although not nearly as many as there are producers.

(2) The product of each seller is like that of other sellers of the same class or kind of article. Here, again, in the case of standardized farm products this requirement for perfect competition exists.

(3) Each seller tries to sell at the highest price, and each buyer to buy at the lowest price possible. To the extent that buyers and sellers do not attempt to protect their individual interests in this way, competition is impaired.

(4) Each buyer knows where he can buy at the lowest price, and each seller knows where he can sell at the highest price.

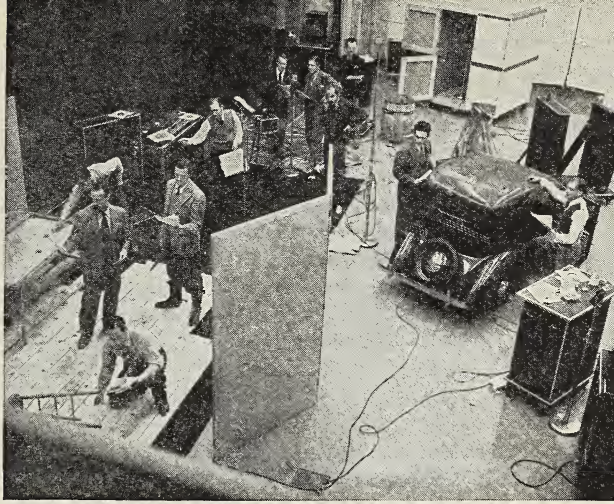
As we see when we examine the matter, all of the above conditions are to be found in few actual cases. On the other hand, there are not a great many cases of pure monopoly. The fact is, in the determination of the prices of most articles, there are present some of the elements of both competition and monopoly.

Most Prices Are Determined by Imperfect Competition. From the standpoint of the supply of a good, we now see that there are two extreme possibilities. On the one hand, there may be so many producers that what one produces has no measurable effect on the market price. On the other hand, there may be only one producer; in which case he is free to fix the price as he pleases, unless forbidden to do so by government.

In most cases, however, goods are not produced under conditions of either pure competition or pure monopoly. For example, only a few large companies produce nearly all the automobiles, cigarettes, tractors, chewing gum, packing-house products, typewriters, adding machines, electric equipment, and a large number of other commodities that are commonly used. None of the companies produces the entire market supply.

Sound Effects for a Radio Program

Radio programs are used by producers to convince the buying public that their products are superior to those sold by their competitors.



National Broadcasting Company

But each one produces an important part of the total supply, so that if any one should stop production, it would be possible for the others to raise their prices because the total supply would be less.

Product Differentiation Reduces Competition. Mrs. Jones uses a certain brand of soap. And her husband probably uses one particular brand of shaving soap or other shaving preparation. Their daughter and Mrs. Jones use certain brands of cosmetics. Why do they use these brands? The answer is, partly because they think that each of the articles is better than others of the same general kind and partly because of habit. To begin with, it is possible that they became interested as a result of a radio program, a persuasive advertisement, or the style of the container of the article. Then after having become accustomed to the brand, its use became more or less a habit.

Of course, there are slight variations in the quality and the values of many kinds of consumers' and producers' goods, but evidently not as much as most of us ordinarily believe. If one brand were as much superior as its maker claims that it is, it would not be long before all the other producers would have to go out of business, because people would cease to buy their products.

But producers know that certain people like certain qualities in the articles they use. And they know that many people can be made to believe that their products are peculiarly different

2. What conditions led to the establishment of the Interstate Commerce Commission?
3. Why was it necessary to pass the Sherman Antitrust Act?
4. What is the Federal Trade Commission and how does it operate?
5. Booth says that the prices of wheat and cotton should be controlled by limiting the quantity of each product that farmers may grow. Barnes contends that a fair price should be fixed for each product by law. Which, if either, do you think is right?
6. Name some commodities and services produced in your community, the prices of which are determined by competition; select others, the prices of which are partially controlled by government. Explain why the prices are determined in these ways.
7. Is the influence of potential competition of more importance in connection with competitive prices than with monopoly prices?
8. Efforts are occasionally made to have the Government guarantee certain minimum prices. Suppose the Government should guarantee a price of 15 cents a pound for cotton and $2 a bushel for wheat; that is, the Government would buy the products if the market prices fell below these figures. What would be the effect on consumers? on the quantities of cotton and wheat produced? on other crops?
9. Why was President Theodore Roosevelt called the man with "the big stick"?
10. Discuss imperfect competition.

TOPICS FOR SPECIAL REPORTS

1. A recent law that is intended to control or influence prices.
2. The Federal Trade Commission.
3. The relation of monopoly and competition to the great American fortunes. (Rockefeller, Carnegie, Astor, Vanderbilt, Gould, Hill, Morgan, Reynolds, Harriman, Ford, Hutton, and others.)
4. Why monopoly prices may be fair prices.
5. Robinson-Patman Amendment to the Clayton Act.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. In most instances does competition result in fair prices?
2. Is the cost of producing an article the most important factor in the determination of the price of the article?
3. Under competitive conditions will there always be marginal producers?
4. Are private monopolies justifiable?

CHAPTER 14

PUBLIC-UTILITY PRICES

A merchant, as a rule, may fix the prices of his goods as he pleases. Moreover, if he chooses to do so, he may refuse to sell goods to anyone.

But the ticket agent at the railway station cannot charge one passenger more for a particular kind of ticket than he charges another. Furthermore, the agent cannot refuse to sell a ticket to anyone who asks for it and who is willing to pay the regular price, provided the purchaser complies with the usual requirements for passengers.

Why is it that in some kinds of business one customer may be charged more than another or customers may be chosen, while in other kinds of business all must be treated alike? The answer is that some kinds of business enterprises are public utilities and others are not.

Public Utilities Are Privately Owned. Public utilities are privately owned, but they are not free to fix the prices of their products or services or to carry on their businesses as they please. Examples of public utilities are express, railroad, electric, telegraph, telephone, streetcar, bus, truck, and water companies that are owned by private corporations.

Similar industries or businesses are sometimes owned by government. Government-owned enterprises include the post office, and some electric-power, gas, water, and street-transportation facilities. These, however, should not be confused with those that are privately owned. For it is with those owned by private corporations that we shall deal in this chapter.

Public Utilities Differ from Other Businesses. A public utility must obtain a permit or franchise from the government before it can engage in business. The public utility cannot charge one customer more than another nor change its prices

without permission from the government. It cannot select its customers. Finally, it cannot discontinue business until the government grants its permission.

Thus you see that a public utility does not have the same amount of freedom as do other kinds of privately owned enterprises. On the other hand, a public utility has one important advantage: It is protected to a certain extent from unrestrained competition. As we have just said, a company must obtain a franchise from the government before beginning business. To obtain the franchise, it must be able to show to the satisfaction of the governmental authority that there is a real need for the services that the concern applying for the franchise proposes to furnish. Therefore once a business obtains a permit to operate as a public utility, it enjoys a certain degree of monopoly privilege. While it may become possible for other concerns to obtain permission to conduct businesses that will take away some customers, they must show that a sufficient demand has developed to justify the formation of another public utility.

Government Regulation Is a Substitute for Competition. In those industries that are free to compete with each other, competition is relied upon to determine reasonable prices. In the case of public utilities, however, government regulation is substituted for competition as a means of controlling prices. The electric-power and light company, the railroad company, or any other public utility is in a different position from that of other producing concerns. It produces a service that is very much needed by many persons. If there were no public authority to control prices, it might raise its prices to an unreasonable level, and the public would be helpless. For example, the telephone company might increase its rates by 100 per cent, and the public would have to pay the price asked or would have to go without telephone service; whereas if a grocer raised his prices too high, people would go elsewhere because it is probable that other grocers would be willing to sell the same or similar kinds of goods at lower prices.

Thus we see that public utilities are protected, either partially or entirely, from competition. In return for the protec-

tion thus obtained from government, the public utility must give up its power to fix the prices of the services it sells.

Why Are Certain Industries Public Utilities? Industries that are considered by the people to be "affected with a public interest" are classed as *public utilities*. An industry that is "affected with a public interest" is one that produces services that are necessary to modern life, that produces services for sale to the public, and that naturally tends to become a monopoly.

An examination of the meanings of these statements explains why railroads, electric-power and light companies, streetcar companies, and others have become public utilities. Each of them supplies a service that is essential to modern life in the territory where it operates. Each of them supplies a service that is purchased by the public. And, finally, they are natural monopolies. A *natural monopoly* is an industry the price of the products of which cannot, in the interest of the public welfare, be fixed by competition.

Highway Trucks

Truck companies engaged in interstate traffic as public carriers are subject to regulation by both state and Federal Governments.

Fruehauf Trailers, photo by Smith Brothers

Competition by Natural Monopolies Is Not Desirable. In the case of natural monopolies, competition is not desired by the public. For example, suppose several gas companies were allowed to supply a town or a city with fuel. The streets would be constantly torn up by rival companies as consumers switched from one company to another. Or suppose that there were several telephone companies in your town or city. In order to supply services to the people, each company would have its own lines and other equipment, which would make the service more expensive. And, in addition, each subscriber would need as many telephones as there were telephone companies.

In every case of public utilities it is desirable to limit competition, because competition is not desired by the public nor is it practicable owing to the large amount of investment needed in order to supply the service.

Before the establishment of the Interstate Commerce Commission there was little effective control of the railroads. In many cases railroad companies fought each other bitterly. Where there were two competing lines between cities, the desire for business sometimes caused the railroads to reduce rates so low that eventually one or both of them became bankrupt. In order to try to make up its losses, a railroad, would fix rates that were unreasonably high, between places where it had no competition, and the public had to pay the charges because there was no other method of transportation available. Moreover, in regions where there was no competition, the railroads often paid little attention to the quality of the passenger and the freight service that they rendered. Passenger coaches and freight cars frequently were inferior, and schedules were uncertain.

Under the conditions it seemed that only those companies that were the most ruthless in their methods of competition could survive. It was a struggle to the bitter end until the weaker or more helpless competitor had become bankrupt and the stronger road had acquired complete control of transportation in the territory. When this occurred, the more fortunate railroad company then proceeded to charge any rates it chose and to give the kind of service it found most profitable.

At first the states tried to control the rates and the services of the railroads. But because railroad lines usually extend across state boundaries, state control failed. It was impossible to get the state governments and commissions to co-operate to the extent necessary for success. Consequently it became necessary for the Federal Government to undertake the control of interstate commerce. In 1887 Congress passed a law setting up the Interstate Commerce Commission.

Public Utilities Are Regulated by State and Federal Commissions. Generally speaking, public utilities that operate entirely within a state are subject to control by the state government. Those whose activities extend across a state boundary are subject to control by the Federal Government. For example, a taxi or an electric-light and power company that confines its services to people living within one state is subject to regulation by that state government. The same would be true of interurban railroads. Railroad lines that cross the state boundary, however, are regulated by the Federal Government. The reason for this is that under the Constitution power to regulate intrastate commerce is reserved to the states, while Congress is given the power to control interstate commerce.

Both the state legislatures and Congress attempt to control public utilities by means of commissions composed of individuals whose duty it is to see that the aims of the government are carried out. Each of the state legislatures appoints such public-service commissions as are deemed necessary.

There are many Federal commissions for controlling public utilities engaged in interstate business. These commissions, together with the services over which they have control, are:

Interstate Commerce Commission—rail and motor-carrier industries.

Federal Communications Commission—telephone, telegraph, and radio industries.

Federal Power Commission—navigation, water power, electric light and power, and natural gas.

United States Maritime Commission—interstate, foreign, and intercoastal commerce by water.

Civil Aeronautics Authority—air carriers.

A Popular Radio Program

The radio industry is controlled by the Federal Communications Commission.

In addition, the following departments and agencies of the Federal Government exercise a certain amount of control over public utilities engaged in interstate business: the Department of Agriculture; the Department of Justice; the Securities and Exchange Commission; the National Labor Relations Board; the Federal Trade Commission; the National Mediation Board; and the Wages and Hours Administration.

There Are Three Aims in Regulating Public Utilities. In the first place, the public is entitled to adequate service. By this we mean as much service as everyone wants and is willing to pay for at a price that is only slightly above the cost of producing the service. In the second place, persons and concerns who own the public utilities are entitled to a reasonable return on their investments. In practice this amounts to saying that utilities should charge only enough to pay the owners of stocks

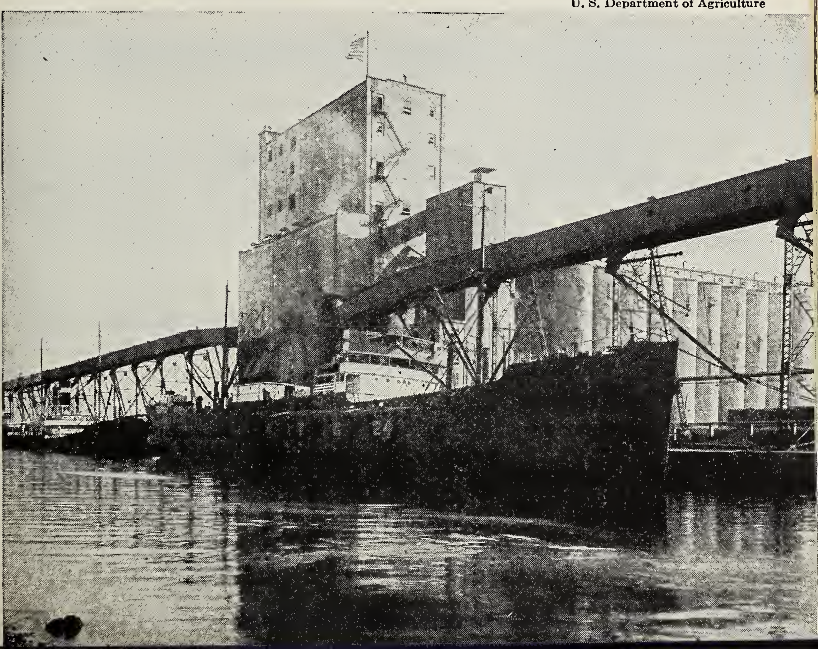
or bonds of the companies a low rate of profit or interest. In the third place, public utilities should not discriminate between persons in rendering service or in making charges for services. For example, no railroad should charge one person more than another for a coach ticket for a certain number of miles, nor should one farmer be charged more than another for shipping the same amount of a certain kind of produce a given distance over the same railroad.

On the other hand, transportation companies may discriminate as to charges for hauling different kinds of products. To illustrate what is sometimes meant by *rate discrimination,* suppose that a railway carried both silk and coal between the same two cities. In order to encourage both the production and the use of coal, it might haul the coal for about the actual cost of transportation and might charge much more than the cost of transportation for hauling the silk. In this way the lack of profit in transporting coal would be offset by the gains in transporting silk.

Loading Wheat for Export

Water transportation for foreign commerce is controlled by the United States Maritime Commission.

U. S. Department of Agriculture



There Are Two Principles in Public-Utility Regulation. How much should a railroad, electric-power and light, or other public-utility company charge for its service? This is the most difficult problem for the public-service commission to solve; for, as a rule, no matter what the rate may be, there will be complaint. The public is likely to feel that the rates are too high; and the stockholders in the company, that the rates are too low. Since both parties, the public and the investors, are entitled to fair prices for the services supplied by the utilities, the question is a very important one for all of us to consider from both points of view.

In fixing rates, commissions may be guided by one or both of two principles: (1) the cost of the service and (2) the value of the service. According to the first principle, rates should be fixed slightly above the cost of rendering the service. According to the second principle, rates should be fixed in proportion to the value of the service to the customer.

Thus we might say that the utility company should not be required to haul a ton of coal for less than the cost of transportation. On the other hand, it might be said that the user of the coal ought to be willing to pay the railroad company as much as it is worth to the user to have the coal transported to him. But if we agree to follow either of these principles, we find it difficult to say just what the transportation rate should be.

What Rates Should Railroads Charge? In order to try to answer this question, it is necessary to consider (1) the nature of the services furnished by railroads and (2) the kinds of costs involved in railroad transportation.

Kinds of Service. As we know, railroads supply two general kinds of transportation, that for passengers and that for goods. We know, too, that there are different classes for each of these kinds of transportation. For example, there are day-coach and Pullman services for passengers. And freight is classified according to the nature of the goods, as first-class, second-class, and so on, depending upon the kind of handling required in shipping the goods.

Kinds of Costs. As in the case of other large industries, costs of production for a public utility may be classified as fixed and variable. As we have seen, fixed costs include those indirect costs that do not vary much in proportion to the amount of service produced. Variable costs are those direct costs that tend to vary with the amount of goods or service supplied. Besides, the production of goods and services may involve *joint costs.* In the case of a train made up of day coaches and Pullman cars, the cost of coal used in generating steam for the engine is a joint cost.

Depreciation as a Cost of Production. The variable costs in railroad transportation include coal, oil, water, labor, and materials. A fairly accurate record of these is usually kept, and for that reason variable costs can be known.

Fixed costs include the salaries of executive officers, office expenses, interest on borrowed money, and depreciation. While it is comparatively easy to find out from the accounting records just how much the total of some of these expenses amount to, it is very difficult to estimate the amount of depreciation of railroad property. For example, a railroad engine loses part of its value each time it makes a run. Likewise, the rails decrease in value with use and eventually have to be replaced.

Depreciation as a cost of production is just as real and as important as any other cost. It should always be included as part of expenses. The problem is to determine just how much should be allowed to cover the expense due to depreciation. The passenger or freight rate must be high enough to include all direct and indirect expenses, including the decreases in the value of property.

Valuation of Property. The importance of the valuation of public-utility property in fixing rates can be seen if we assume that the value of the property owned by a railroad company is $100,000,000. Suppose we say that the investors are entitled to 5 per cent on this value. If there were no bonds, the rates charged should be high enough to cover the amount of fixed and variable costs and $5,000,000 as profit for the stockholders.

If the same property is valued at $200,000,000, and a profit of 5 per cent is to be allowed, it would be necessary to fix rates high enough to leave a profit of $10,000,000 after all expenses were paid.

Failure to fix rates high enough to allow for a reasonable return on the investment results in the use of private property by the public without due compensation to the owners. Rates that are too high, however, cause the public to pay more than is reasonable for essential transportation services, and they also enrich stockholders at public expense.

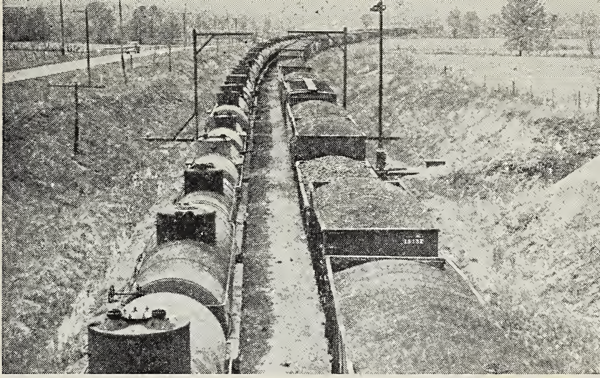
The problems involved in the valuation of railroad and other public-utility property are very difficult. Even the experts cannot agree, in any particular case, although they may agree as to the principles that enter into valuation. We are not surprised, therefore, that there is so much argument even among experts as to whether utility rates are too high or too low.

How Are Railroad Rates Fixed? As we have seen, much of the cost in railroad transportation is joint cost. It is impossible to say exactly what part of the costs of depreciation, coal, water, or any other item of overhead or direct expense should be charged to any one shipment or class of shipments.

Because of the difficulties of assigning to any shipment its share of the total cost of maintaining and operating the railroad, it is necessary for the Interstate Commerce Commission to rely largely on the value-of-service principle in determining rates.

In popular language, the *value-of-service principle* means "charging what the traffic will bear." When this principle is used, the purpose is to charge enough to cover variable expenses, but no attempt is made to apportion to each class of goods its rightful amount of fixed costs.

For example, we can see that over a period of time a railroad company must have enough income to cover its total expenses; otherwise it will become bankrupt. But suppose the charge for hauling coal covers the variable expenses but less than a proportional part of the fixed costs, while the charge for hauling silk is high enough to cover the variable expenses and more than the proportional amount of fixed costs belonging



Coal and Oil Trains Passing Each Other

The Interstate Commerce Commission tends to follow the principle of "charging what the traffic will bear" in fixing rates for various commodities.

New York Central System

to this classification of freight. Under the circumstances we would say that the rate on coal is low and that the rate on silk is high. Because of the low value of coal in comparison with its bulk, it could not stand so high rates as silk; that is, many consumers of coal could not afford to pay a higher price that would result from an increase in the charge for freight. An increase of 10 or 15 cents per ton in the freight charge on coal might result in a great decrease in the amount shipped, while a considerable increase in the rate on silk would have little effect on the quantity of silk shipped. Therefore, as it is said, both coal and silk are charged all the traffic will bear.

The tendency of the Interstate Commerce Commission to follow the value-of-service principle to a great extent in fixing rates is justified on the grounds of public welfare. The rates for bulky articles, like hay, coal, and timber, are low as compared with certain other rates because high rates would result in higher prices for the commodities. If prices were too high, many people could not afford to buy the goods. It is, therefore, the general purpose of the Commission to fix rates, as a whole, high enough to enable the railroads to earn a fair income for investors without trying to recover more than the costs of hauling any particular kind of goods.

What Is the Future of the Railroads? During the years between 1930 and 1940 most of the railroads in the United States were faced with great financial difficulties. In 1929 the total net profits of Class I railroads amounted to about $896,806,000. In 1932 profit gave way to a deficit of $139,203,000, a decline of over one billion dollars within two or three years. In 1939 the amount of net profit was about $93,000,000, about one

tenth of what it was ten years before. So great were the losses of some of the railroads during the depression of the 1930's, the Government loaned them huge sums of money in order to prevent the bankruptcy of the companies.

In 1916 the average return on investments in railroad property was nearly 6 per cent; in 1938 it was about 1.43 per cent. A great many railroads found it difficult in the period from 1930 to 1940 to earn enough to pay even the interest on borrowed money, much less to make any profit for the stockholders.

What was the cause of the plight of the railroads? We cannot give an answer to this question that would be satisfactory to everyone. The railroads claimed that one of the reasons why they were in difficulty was that they were treated unfairly by government. They pointed out that the public is taxed to build roads that motor-truck companies are allowed to use without having to pay a just amount for the use of the roads. This enables the truck companies to haul freight at less expense than would be the case if truck companies were compelled to pay higher taxes. It is also contended that the wages of railroad workers have increased greatly, while freight rates have gone down. It is claimed that since 1916 railroad hourly wages have more than doubled.

On the other hand, there are those who say that the difficulties of the railroads were not caused by competition by other means of transportation or by unfair governmental regulation. They argue that in many cases railroad management was inferior and wasteful, that the equipment used was poor, and that the railroads should have consolidated into a few large systems and thus eliminated a great deal of expense in the form of high executive salaries. It is also claimed that railroad property was overvalued, to which the railroads reply that the amount of stocks and bonds held by the public is a great deal less than in 1910.

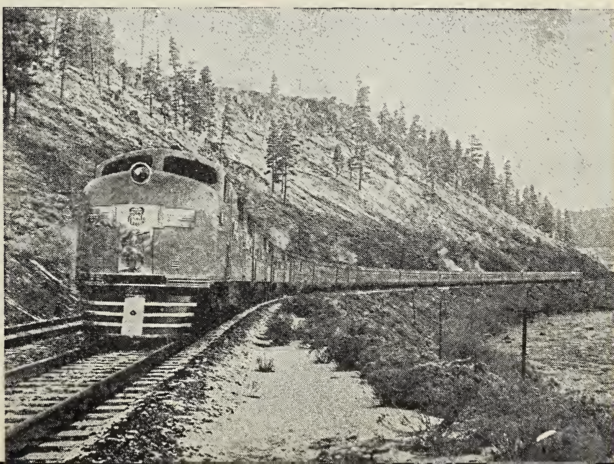
When we began to get ready for war after 1939, the business of the railroads improved. Within a year or two all the roads were busy. By 1944 both freight and passenger traffic were so great that the railroads could hardly meet the demand. How

long the prosperity of the railroads that resulted from war conditions will continue cannot be predicted.

Should the Government Own the Railroads? Some persons are convinced that the Government should own and operate the railroads. They feel that the railroads should be the property of the public, as are the public highways and the post office. Those who favor government ownership contend that the Government could operate the railroads more economically than can private companies.

Traditionally, however, the American people have opposed government ownership of railroad facilities. Those who oppose ownership by the Government say that it would be impossible to set a satisfactory value on the property in order to determine the amount the Government would pay the owners if it should buy the railroads. Moreover, many feel that government operation would be less satisfactory than at present and that wastes of various kinds would be greater than under private ownership.

The final conclusion to the argument will rest with the people. If they want the railroads to become another public industry, laws will be passed authorizing the Government to acquire ownership. If they prefer that ownership remain with private companies, rates and services will continue to be regulated by the Government; and railroad management will have to try to find more efficient ways of supplying transportation services to the public, if they are to be prosperous.



A Modern Passenger Train

Should all interstate railroads be owned by the Federal Government?

Union Pacific Railroad

How Are Other Public-Utility Rates Fixed? The rates for other public utilities are fixed in the same general way as are those for railroads. Of course, the particular problems involved are different, but the fundamental questions and the principles to be followed are the same. For example, in fixing the rates that an electric-power and light company is allowed to charge, the public-service commission tries to arrive at a rate that will be fair to both investors and to the public.

What Are Public-Utility Holding Companies? The holding company has played a prominent part in public-utility history. This has been especially true in the case of electric-utility companies, although holding companies have been formed to control every other type of public utility.

We must not confuse public-utility holding companies with operating subsidiaries. An *operating subsidiary company* is one that is engaged in the production and distribution of electricity or of a service, such as transportation, while the *holding company* is one that holds a controlling interest in the capital stock of the subsidiary.

One of the objects in the formation of public-utility holding companies is to enable the operating subsidiaries to operate more economically. For example, the holding company might be able to buy large quantities of supplies and materials at a lower price than could one of the operating subsidiaries. By distributing such supplies and materials to the subsidiary companies, the cost of service could be reduced. Also, when a subsidiary needs more capital, the holding company, because it is better known, can often sell bonds or stocks at a higher price than can the operating company. Thus in many instances the holding company has been able to raise the money needed by small operating subsidiaries for extending their lines into new sections where electricity is needed.

Unfortunately the holding company has sometimes used its power over its subsidiaries to "milk" the operating companies. In various ways certain holding companies have exacted from the operating subsidiaries dividends to which they were not entitled. As a result, rates to consumers have sometimes been kept too high. At the same time, the payment of too much of

their income to the holding company has taken funds needed for improving the service to the public.

In 1935 Congress passed the Public Utility Act, which gives the Securities Exchange Commission the power to exercise a great deal of control over public-utility holding companies. Under the law, holding companies cannot issue new stocks and bonds without the permission of the SEC, nor can they buy stock in other companies without the approval of the Commission. All dealings between holding companies and their subsidiaries must conform to the requirements laid down by the Commission. Finally, the SEC has the power to order holding companies to dissolve or to reorganize when their organization does not conform to the law.

Are Electric Rates Reasonable? Within recent years we have heard a great deal about public-utility rates, but especially those for electrical energy. It has been said that public-utility companies charge too much for current, that they do not extend their lines into territories where people are in need of electric power, and that the service is inferior. On the other hand, the power companies claim that rates are reasonable, that rates have been going down over a period of years, that transmission lines have been extended into new territory as fast as there was enough demand to justify the expense of building additional lines, and that the service has been as good as it was possible to give, considering the rates paid by consumers.

Several years ago the Government formed the Tennessee Valley Authority, which is an agency owned by the Federal Government. The TVA was formed to erect dams on rivers in the Tennessee Valley for the control of floods, to improve the navigation of rivers, to manufacture nitrates, and to carry on other kinds of work. It was also empowered to generate and sell incidental or surplus electrical current developed by its plants.

It has been claimed that the TVA can determine how much it costs to produce electrical energy and that its rates can be used as a yardstick to fix the rates for privately owned public-utility companies. Before the Government entered the field, the towns and other communities in the Tennessee Valley were served by privately owned public-utility companies. The rates

U. S. Bureau of Reclamation

Grand Coulee Dam, Washington

Prices charged by power plants owned by the government are fixed by the government; and goverment regulates the rates charged by privately owned power plants.

offered by the TVA were lower than those charged by the public utilities. Because they could not compete with the TVA, the private companies were compelled to reduce their rates or to sell their property to the cities or to the Government.

Many people claim that the TVA rates are not a fair measure of the cost of producing and distributing electrical energy. It is said by critics that, while it is true that the rates set by the Authority are low, the price paid by consumers does not cover costs of generating and transmitting the current. In other words, it is charged that the Government conducts the sale of electrical energy at a loss and that the loss is made up from taxes collected from all the people. Those in charge of the TVA, however, contend that the rates charged consumers are not too low and that the current is not sold at a loss.

Should the Government Regulate Other Prices? Until recent years government in the United States had not attempted, to any great extent, to control prices and production except in the cases of public utilities and a few other monopolies. Since 1930, however, there has been a great deal of agitation for more control by the Federal Government. In response to public demand many laws have been passed to give Government a large degree of control over industries that before had always been practically free from governmental interference.

In 1933 the National Recovery Act was passed, giving the Government the power, directly or indirectly, to exercise a great deal of control over production, wages, and prices in indus-

try and business. In the same year the Agricultural Adjustment Act was passed. This Act was designed to aid farmers by raising the prices of agricultural products. Both of these acts were declared unconstitutional by the Supreme Court. But since then other acts have been passed that give the Government power to regulate certain conditions and prices in industry. In 1938 another Agricultural Adjustment Act was passed, giving the Government even more powers than did the Agricultural Adjustment Act of 1933.

The AAA of 1938 provides for (1) payment of sums of money to farmers who agree to limit the acreage of certain kinds of crops, (2) loans on crops, (3) crop insurance, (4) enforcing agreements of farmers to limit production of certain crops to certain amounts each year, (5) disposal by the Government of any excess or surplus that has been accumulated and that may be needed during poor crop years. The general aim is to raise prices of corn, wheat, cotton, tobacco, and rice.

Farmers are not forced to comply with the provisions of the Act, but they cannot receive the benefits of the law unless they agree to abide by its requirements. If a farmer does not agree to limit his production, he is not eligible for loans or insurance on the crops he produces.

Under the Act, quotas of production are assigned each farmer after he has agreed to abide by the Act. For example, if a wheat farmer agrees to operate his farm according to the provisions of the Agricultural Adjustment Act, the total acreage that he may plant is fixed by a government agent. When harvest time comes, if the price of wheat is low, the farmer will be extended a loan on the amount of his quota. For example, if his quota is 1,000 bushels of wheat, he might possibly be allowed a loan of 60 cents a bushel on 1,000 bushels, or a total of $600. The wheat is then stored until such time as the Government decides it may be sold. If it is sold for a dollar a bushel, the Government keeps the 60 cents a bushel it loaned to the farmer and gives him the remaining 40 cents. If the price remains below 60 cents, the Government may take over the wheat in payment of the loan. The farmer would thus, in effect, be guaranteed 60 cents a bushel. During the war the amounts the Government would loan on crops were increased. Thus the law provides a

method by which the Government attempts to control the prices of certain farm commodities.

In 1936 the Robinson-Patman Act was passed to give protection to the "little fellow" in business and to control competition. The law forbids any seller engaged in interstate business to discriminate between customers as to price or services.

The three laws mentioned above are only some instances that show that Government, more than ever before, is tending to extend its control over business and industry. As was to be expected, every effort of the Government to control prices and other matters relating to the conduct of business and production has met with strong opposition. On the other hand, there are those who insist that times have changed and that more governmental control is absolutely necessary. Every move in the way of governmental control is cited by some individuals as proof that the Government intends to change all kinds of industry to the position of public utilities or public industries. At the same time, others frankly are saying that the Government has not gone far enough in the way of control and ownership of business and industry. A few even wish to see the Government take over the ownership of the railroads, coal mines, water transportation, and all kinds of manufacturing, marketing, and farming.

Thus we see that the questions of control of business by government are involved, and regardless of what is done to solve them, it is unlikely that everyone will be satisfied. While the task of finding a solution is not easy, we cannot evade the results of the methods that are chosen to solve them. For that reason every intelligent citizen should be concerned with the relations between government and the matters that have to do with making a living and with prices.

QUESTIONS ON THE CHAPTER

1. What are public utilities? Give examples of two public utilities.
2. Give two examples of government industries.
3. What are the distinctions between a public utility and a government industry?
4. What advantages does a public utility possess over a privately owned enterprise?
5. Why are public utilities protected from competition?

6. When are public utilities under the control of the state government? When are they under the control of the Federal Government?
7. List five Federal commissions for controlling public utilities.
8. What is meant by rate discrimination by transportation companies?
9. What principles should be observed in rate fixing?
10. How does the factor of *joint costs* affect the problem of rates in transportation?
11. Why is it difficult for railroad companies to estimate the costs of depreciation?
12. How did World War II affect the railroads?
13. What do you understand by the principle of *value of service?*
14. What is meant by "charging what the traffic will bear"?
15. What are the purposes of a public-utility holding company?
16. What is a "reasonable" rate for electric power?
17. What provisions were included in the Agricultural Adjustment Act of 1938? Has this act solved the problem of the farmer?
18. What is the meaning of each of the following terms?

    (a) **Agricultural Adjustment Act**
    (b) **holding company**
    (c) **Interstate Commerce Commission**
    (d) **joint costs**
    (e) **National Recovery Act**
    (f) **natural monopoly**
    (g) **operating subsidiary company**
    (h) **public utility**
    (i) **Public Utility Act**
    (j) **rate discrimination**
    (k) **Robinson-Patman Act**
    (l) **TVA**
    (m) **value-of-service principle**

APPLICATIONS OF THE CHAPTER

1. What legislation was passed in 1935 to control the holding companies?
2. How were investors in many public-utility companies in some states affected by the TVA? (Consider especially the case of the Commonwealth Southern Company.)
3. It has been suggested that the TVA plants cannot be used as yardsticks to furnish "reasonable rates" because they do not include as costs of production such items as taxes, enough depreciation, and interest. Discuss.
4. Why did the Wheeler-Rayburn Public Utilities Act create so much controversy?
5. How will an increase in air transportation likely affect the railroads?
6. What would be some arguments for and against the consolidation of the railroad companies into a few large companies?

7. Give as many reasons as you can to explain why grocery stores and drugstores are not public utilities. Under what conditions would they become public utilities?
8. Take the case of a public utility in your city or community, and explain how a government commission would go about fixing the price of the service it renders.
9. Are there possibilities that automobile factories will become public utilities? What would happen if the Government fixed the selling prices of automobiles too low? if it fixed the prices too high? Could the Government know what would be a fair price?
10. Make a list of the arguments for and against an extension of government control over business. On the whole, which arguments seem the stronger?

TOPICS FOR SPECIAL REPORTS

1. The work of the Interstate Commerce Commission.
2. The Tennessee Valley Authority.
3. The decrease in electric rates since 1910.
4. The work of the Agricultural Adjustment Administration.
5. The organization and work of the public-service commission in your state.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Can the TVA be used as a yardstick for fixing fair electric rates?
2. Should the railroads be owned by the Government?
3. Should "value of the service" be the principle to be followed in fixing public-utility rates?
4. Could the Government fix fair prices for farm and all manufactured products?

UNIT V

Money and Credit

What money and credit are,
and how they are used.

Ewing Gall

Money and Credit

A bank deposit involves both money and credit.

CHAPTER 15

MONEY

It would be pretty difficult for us to live without money. Of course, we do not use money directly to satisfy our wants. But we do use it as the means for obtaining most of the goods we consume. Moreover, the ownership of money gives one a sense of security, which is pleasant. And, if one has enough money, he is likely to find that his riches will help him to win recognition from certain individuals.

Money has been in use for a long time. Frequent references to money are to be found in histories of ancient Egypt, Greece, and Rome. And during the Dark Ages in Europe, after the fall of Rome, trade was carried on to some extent by the use of money.

But in those olden times money played a much less important part in the lives of the people than it does today. During the Middle Ages the serfs and villeins, who made up most of the population, lived in villages near the great manor, which was occupied by the "lord." Nearly everything used by the people was grown or made by the people themselves. There were no stores from which they could buy groceries, clothing, and other things. Although money was not unknown to those in the lower economic groups, it was not frequently used. Nor did the lord himself have to depend upon money for most of the things he needed. Each of the villeins paid him small rents for their houses and land, and, in addition, worked one or more days each week for him. Luxuries, such as silks, spices, works of art, and other rare goods, were sometimes purchased by members of the nobility.

Under the conditions, therefore, money in those days was not so useful as it is now. There were few goods to be bought. The masses of the people were nearly economically self-sufficient; that is, they produced most of the things they needed.

And the upper class of society did not have to possess much money in order to exercise power over goods and the services of others. The fact that a man was a lord entitled him to a large part of the services of those who lived on his domain.

Now people work in hundreds of different kinds of occupations. They are free to move around from place to place. Few persons produce many of the things they use. And there is scarcely any limit to the kinds and the amount of goods that one can buy, if he has the money. Therefore the great majority of people of all classes depend upon the power that money gives them for the goods and the services they need.

How Did Money Come to Be Used? Like nearly everything else we use, our present forms of money gradually came into existence. At first, barter was the means employed in trade and exchange. But as the number of goods that people wished to exchange increased, the use of barter became more and more unsatisfactory. As a result, people began to use certain things for money. Just what money is will become clearer as we study the remainder of this chapter.

The Difficulties of Barter. The use of barter as a means of exchange raises some serious difficulties. Suppose, for example, a man has more wheat than he really needs for his own use and that he would like to exchange it for a pair of shoes. It would be necessary for him to find someone who had the kind of shoes he needed and who would be willing to take wheat in exchange for them. Granted that the owner of the wheat succeeded in finding a person who had a pair of shoes that he was willing to trade for wheat, it might be very difficult for them to reach an agreement as to the rate at which the commodities should be exchanged. The man with the wheat might think, for example, that the shoes were worth only five bushels, while the other might not be willing to take fewer than ten bushels of wheat for the shoes.

Many years ago a writer on the subject of money gave an interesting illustration of the difficulties that arise when barter is employed as the method of exchange. The following is a quotation from one of his books:

"Some years ago, Mademoiselle Zolie, a singer in the Theatre Lyrique at Paris, made a professional tour around the world and gave a concert in the Society Islands. In exchange for an air from *Norma* and a few other songs, she was to receive a third part of the receipts. When counted, her share was found to consist of three pigs, twenty-three turkeys, forty-four chickens, five thousand coconuts, besides considerable quantities of bananas, lemons, and oranges. At the Halle in Paris, as the prima donna remarks . . . this amount of live stock and vegetables might have brought four thousand francs, which would have been good remuneration for five songs. In the Society Islands, however, pieces of money were very scarce; and as Mademoiselle could not consume any considerable portion of the receipts herself, it became necessary in the meantime to feed the poultry with the fruit."[1]

Early Instances of Money. Long before coins and paper money came into existence, goods of several kinds were used for money. In olden times some good that was desired by nearly everyone came to be used as a medium of exchange. Early writers tell us that the Latins often used cattle. In this connection it is interesting to know that our word "pecuniary," which pertains to money, is derived from the Latin word *pecus*, which means flock or herd. Homer, a famous Greek writer, stated that the value of the armor of one of the ancient heroes was so many head of oxen.

Among the American Indians, wampum, or colored beads and shells, was used in trade. Eventually wampum was often used as a medium of exchange between American colonists. In 1619 the General Assembly at Jamestown, Virginia, passed a law that resulted in making it possible to use tobacco as money. A little later corn and musket balls were often used as money in Massachusetts. In 1719 the Assembly of South Carolina passed a law that rice should be receivable for taxes. Subsequently rice came into general use as money in that colony. In Tennessee and Kentucky, as well as in other settlements, deer and raccoon skins circulated in the place of coins.

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[1]JEVONS, W. STANLEY. *Money and the Mechanism of Exchange*, Chap. 1. New York: D. Appleton and Company.

Courtesy of Chase National Bank, New York

Coins Used in the American Colonies

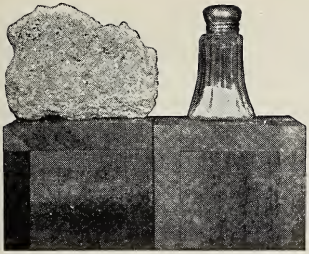
This illustration shows the sides of a Spanish milled dollar, one of the "pieces of eight" mentioned by Robert Louis Stevenson. The Spanish milled dollar was widely used in American colonies.

Early Coins. The first known coins were those made in Lydia in about the seventh century B. C. The first Roman coins were bronze and were made about 400 B. C. About two hundred and fifty years later silver and gold coins were made by the Romans.

Money in Use at the Present Time. Our monetary system at the present time is very complex. For example, we use gold, silver, copper, and nickel, as well as several kinds of paper money. In addition, as we shall see later, credit serves as a medium of exchange to a far greater extent than do coins and paper money. Under the conditions of modern life it seems desirable to use all of these as mediums of exchange. But the complexity of our system of money and credit creates problems that tax the thinking of some of the best minds in the country.

Money Performs Several Functions. The primary function or use of money is to serve as a medium or means of exchange. As we know, sellers ordinarily exchange their goods for money, and buyers usually exchange money for goods.

But in order to be a satisfactory medium of exchange in the modern business world, anything that serves as money must perform several secondary or incidental functions, which are discussed below.



Salt Money

At one time salt was used as a medium of exchange. Legionaries under Caesar received part of their pay in common salt. That part was their "salarium," and it was from this ancient Latin word that our own word "salary" was derived.

Courtesy of Chase National Bank, New York

Money as a Measure of Value. When a commodity like gold, for instance, is used as money, one of the functions performed by it is that of serving as a measure of value.

As we have seen, the individuals who wish to exchange goods must first form estimates of the value of the respective utilities of the goods. For this reason a standard for stating values is needed. The usual standards for measuring volume, distance, or weight—such as a bushel, a foot, or a pound—would be of little use. These are not suitable as measures of value. We can, however, take some one good, divide it into units, and compare our desire for a unit of the good with our desire for other goods or services. In this way the unit of the good selected becomes a unit of value.

Essentially that is what occurred when we adopted the dollar as our unit of value. In 1792 Congress authorized the fixing of either 24.75 grains of pure gold or 371.25 grains of pure silver as our money unit, and decreed that these quantities of gold or silver should be called a dollar. As we shall see, the weight of the gold dollar was changed later. Other kinds of money were also authorized, but in each case the value of the money was based on the gold or silver dollar.

Since one may not want to pay as much as a whole dollar for some things, it is convenient to have the dollar broken down into fractional parts, just as the foot measure is divided into inches. In our monetary system, therefore, the dollar has been divided into a hundred parts, and coins ranging from 1 cent (one hundredth of a dollar) to 50 cents have been adopted. We are thus able to buy and sell conveniently things that are valued in fractions of a dollar.

Money as a Store of Value. If you perform a day's work for another person, you expect to receive something in exchange for your labor. If you sell a bushel of wheat or a bale of cotton, you expect something of value in exchange for your commodity. In either case you will probably receive payment in the form of money. Since the money has purchasing power, it might be said that, in effect, you converted your labor or your wheat into money. As long as the money retains its purchasing power, the value of what you sold will remain stored in it. Another illustration of the use of money as a store of value was the frequent practice, in former times, of hoarding gold. Hoarding or hiding money as a method of storing wealth for a long period of time is not practiced as much as it formerly was. But even so, when money is received in exchange for goods or services, it acts as a store of the value of the goods or services until it is spent or until it loses its purchasing power.

Money as a Standard of Deferred Payment. If I wish to buy $1,000 worth of goods, the seller may be willing to sell them to me on account for sixty days. At the end of that time I shall have to make payment. Or I may be able to borrow the amount at a bank and pay cash for the goods. Of course, if I borrow the money at a bank, I shall have to return later the amount agreed upon. So in either case, payment is deferred until a later date, and money is used as the standard to indicate the amount to be repaid.

It may be that, when I return the $1,000, this amount of money will not buy as much as it would have bought when I borrowed it. On the other hand, it may buy more. But, because I repay the same number of dollars, a disagreement as to the amount of purchasing power to be repaid is avoided.

If a good can perform the functions of a measure of value, a store of value, and a standard of deferred payment, it can be used as a medium of exchange. If it is deficient in any of these respects, it does not make a good medium of exchange. But if a thing can be used to measure the value of other goods and services, if it is capable of retaining the value that it is thought to have when it is used in an exchange, and if it can be used to measure obligations that are to be paid later, it can be used to

perform the function that is usually considered the most important; namely, that of a medium of exchange.

Money as a Basis for Credit. In order for business concerns to meet their financial obligations when they fall due, they must keep a reserve of money on hand. Likewise, banks must keep a reserve of cash with which to pay depositors. If it were known that the bank on which a check was drawn had no cash on hand, no one would want the check. The reason why the check would not be acceptable would be that the credit of the bank had disappeared because it had no money. These examples illustrate how money serves as a basis for credit.

In foreign trade, money also acts as a reserve for credit. As a rule, the payments for goods purchased are not made with money; they are made with credit. Through the use of banks, the value of the purchases and of the sales between countries are balanced against each other, and money is used only for the purpose of settling differences when the amounts do not offset each other. The value of credit as a medium of exchange, in both domestic and foreign trade, depends to a great extent on the existence of money.

There Are Seven Qualities of a Good Money Metal. Anything that is used for money must have certain qualities. The presence of these qualities makes it possible for the thing, whatever it may be, to be used as money. Moreover, the thing that possesses these required qualities in the highest possible degree becomes the best medium of exchange.

The qualities of a metal suitable for use as money are: (1) acceptability, (2) portability, (3) durability, (4) homogeneity, (5) divisibility, (6) cognizability, and (7) stability of value. Let us see what these terms mean when applied to money.

Acceptability. The objects that were first used as money had commodity value; that is, they were wanted for themselves. The fact that they could be used to satisfy wants gave them acceptability.

Some of the things that have been used as money have not always been those things that were most needed to sustain life. On first thought one might think that essential commodities,

like wheat, would have always been used as money. If the power to sustain life were the only quality needed, perhaps necessary goods would be the best kind of money. But, as other qualities must be considered, it happens that luxuries have often been used as money. Corn, rice, and cattle have been used; but more frequently things desired for the sake of vanity serve as money. This is true in the case of beads, shells, gold, and silver.

Nearly everyone seems to have a desire for display and ornamentation. At any rate, enough people have that desire to make it possible for all of us to assume that, if we have either gold or silver, we can exchange it for something else. For this reason gold and silver came into use as money before paper currency. In other words, the value of the money depended first upon the value of the commodity of which the money was made.

It was only after a long time, when people had become accustomed to using money principally as a medium of exchange, that it became possible to use as money things like paper bills. Paper money in itself has little commodity value. But if people will accept it as readily as they do gold as a medium of exchange, it is just as useful as gold.

Portability. Naturally if money is to be used as a medium of exchange, it must be capable of being moved from place to place. Lack of portability was one of the defects in the use of cattle. While cattle could be driven from one owner to another, the difficulties in exchanging them for other goods are easily seen.

The degree of portability depends largely upon the value of the commodity in relation to its bulk. It cannot be bulky in comparison to its value. Nor must it be too precious. Platinum, for example, would be too valuable, and coins made of so precious a metal would be very small.

Durability. Since money acts as a store of value and as a standard of deferred payment, it must be relatively durable. Wheat, for example, would not be satisfactory for use as money, partly because it might decay before it could be exchanged for other goods.

Except for wear, gold does not deteriorate easily in value. Unlike iron it will not rust. Gold ornaments that have been

buried for thousands of years have been recovered from Egyptian tombs, and the metal is as good as it was on the day it was buried. While it is softer than some of the other metals, gold can be mixed with an alloy and thus can be made hard enough to resist wear to a considerable extent.

In modern times most of the gold used as money does not circulate a great deal. Most nations keep it in vaults in banks and treasuries and issue certificates against it, the value of which is determined by the amount of gold designated in each certificate. As long as a nation is "on the gold standard," certificates may be exchanged for gold. When a nation goes "off the gold standard," it calls in all the gold and redeems gold certificates with other kinds of money. The other kinds of money continue to be used, but their value may decrease. How much the decrease will amount to depends upon several factors, which we shall discuss later.

Homogeneity. It is desirable that each unit of money have equal value or purchasing power. Lack of uniform value, or homogeneity, was one of the objections to the use of unstandardized commodities, like cattle, shells, and skins. Gold, on the other hand, can be refined until it is pure. Then it can be made into coins. All such coins of the same denomination will have the same value because they will contain the same amount of gold. Gold coins, when they were used in this country, contained one tenth alloy.

Under the regulation of the Government each dollar is given the same value as any other dollar. We have silver certificates and Federal reserve notes, as well as other kinds of paper money. But, as a rule, a five-dollar note of one kind is as acceptable as any other because, for ordinary purposes of exchange, all are uniform in value.

Prior to 1866, state banks issued money. Before these banks were prevented from issuing money, the paper notes in circulation in this country lacked uniformity in value. There were about fourteen hundred state banks in the country, and each one issued notes having its own special designs. In 1866 the National Government imposed a tax of 10 per cent on the notes issued by state banks. This act placed the power to issue

money in the hands of the National Government and the national banks. Uniformity in the value of paper money naturally resulted.

Divisibility. In order that money may serve as a medium of exchange, it must be divisible into different amounts of value. The obvious difficulty in dividing an ox or a raccoon skin suggests at once an important reason for not using these commodities as money. Gold and silver, on the other hand, may be made into coins of different values.

Cognizability. The acceptability of money depends partly upon the readiness with which people recognize the value of the money. If one has a suspicion that a silver quarter or any other piece of money is not genuine, he will ordinarily not accept it.

As a rule, gold and silver coins can be recognized easily. Of course, they may be imitated by counterfeiters, but the Government takes every possible precaution to run down and punish those who attempt to make coins that are intended to be used as money. One reason for the coinage of money is to give it a distinctive design by stamping it with certain figures. Another reason is to prevent the debasement of the coins. The edge of the coin is milled to prevent the removal of metal.

All paper money issued now in the United States is printed by the Bureau of Engraving and Printing at Washington. Each bill or note of every kind and denomination is printed in intricate designs on paper made by a secret process. It is therefore very difficult for anyone to imitate the printed paper money successfully. In spite of these precautions, however, counterfeiting is frequently attempted.

Stability of Value. Metal used for money should be relatively stable in value. The market value of every metal fluctuates with the demand for and the supply of that metal. But some metals fluctuate in value more than others, and those that fluctuate least are the most suitable for use as money, provided, of course, that those metals possess the other six qualities.

The exchange value of money, however, does not reside in the money itself. It depends to a large degree upon outside factors. If you have read the story of Robinson Crusoe, you

will recall that, after his shipwreck, Crusoe was alone on a little island. The wreck of the ship lay near by in the shallow water. By strenuous effort he could swim out to the wreck and salvage some things that he needed most in his new surroundings. Among these were tools and gunpowder. On one of his trips he noticed a quantity of gold and silver, but he did not regard this find as being nearly so important as that of some good knives and forks. He wanted the latter because they would be useful to him. If he had been in civilization, he would have been much more interested in finding gold and silver than he was. Clearly, circumstances make a difference in the value of anything.

And so it is that the value of money may change although the physical quantity remains the same. Moreover, when the money in the monetary system is made up of several kinds, as is ours, the possibility of changes in value is greatly increased. The problem of preventing changes in the value of money is one of the most serious problems with which we have to deal. We shall come back to this subject again.

The Qualities of a Good Money Metal

Acceptability—the metal is readily accepted because it has commodity value and is desired for itself.

Portability—the metal is easily carried; it is valuable in relation to its bulk.

Durability—the metal is affected little by age, use, or exposure.

Homogeneity—equal amounts of the metal have the same value.

Divisibility—the metal is easily divided into units of different sizes.

Cognizability—the metal is easily recognized as genuine.

Stability—the metal is relatively free from great changes in market value.

A Summary of the Qualities of a Good Metal for Use as Money

Why Are Gold and Silver Favorite Money Metals? By considering the qualities needed in money, we can see why gold and silver are widely used as money. To begin with, before paper money came into existence, gold was wanted by nearly everyone. It was not necessary to sustain life, but it could be worked into various kinds of ornaments. Its possession in any great quantity gave distinction to a person, because with the gold he could obtain almost anything he wanted. The same thing was true of silver, only to a lesser degree.

Gold and silver are not perfect moneys. But they do possess the seven desired qualities in a higher degree than any other metals.

Only the Government Coins and Prints Money. Only the Government can coin or print money. It is easy to see why individuals, corporations, and state and local governments are not permitted to issue money. If they did so, the different kinds of money in use would vary as to value, and it would be difficult to buy and sell goods. Most money would not be readily acceptable.

The Constitution of the United States says, "No State shall . . . coin money . . . make anything but gold and silver coin a tender in payment of debts. . . ." And "The Congress shall have power . . . To coin money, regulate the value thereof, and of foreign coin. . . ." Thus the coinage of money became a monopoly of the Federal Government with the adoption of the Constitution.

When the National Government was founded, there was a scarcity of gold in this country. For that reason it was decided to use both gold and silver for the coins of larger denominations, and less valuable metals for those of smaller denominations. The dollar was established as the monetary unit; and as we stated before, its weight was fixed at 24.75 grains of pure gold and the weight of the silver dollar, at 371.25 grains of silver. In 1837, however, the content of the gold dollar was fixed at 23.22 grains. In 1934 it was reduced, the weight being fixed at 13.71 grains, although gold was not coined. Since the beginning of the Government, the silver dollar has contained 371.25 grains of pure silver.

What "Free Coinage" Means. Until we abandoned the gold standard, we had always had what is called the free coinage of gold. Until 1873 we also had the free coinage of silver.

Free coinage does not mean that the money metal or metals will be coined gratis. A charge may be made when the owner of bullion takes his metal to the mint to be coined. The term "free" means that anyone is free to take his metal to the mint to have it coined into money. If the Government charges just enough to pay for the work of coinage, the charge is called *brassage;* if an extra amount is charged, that is, anything in excess of brassage, this amount is called *seigniorage.*

QUESTIONS ON THE CHAPTER

1. What difficulties arise when people depend upon barter to secure the things they need?
2. What types of commodities were used in the past as a medium of exchange?
3. Give five examples of early coins.
4. What metals are used in the monetary system of the United States?
5. Explain how money performs each of its functions.
6. Why do we have a standard measure of value?
7. How does money make it possible for one to store up the value of labor he performs?
8. Does one hundred dollars always mean the same thing? Why, or why not?
9. Explain how money acts as a reserve for credit.
10. What are the seven qualities of a good money metal?
11. Why does the Government have a monopoly on the coinage of money?
12. Why does the Government impose a heavy penalty upon counterfeiters?
13. What is the meaning of each of the following terms?

(a) **acceptability**	(f) **free coinage**
(b) **brassage**	(g) **homogeneity**
(c) **cognizability**	(h) **portability**
(d) **divisibility**	(i) **seigniorage**
(e) **durability**	(j) **stability**

APPLICATIONS OF THE CHAPTER

1. What have you read recently, other than in the textbook, on the subject of money?

2. Discuss fully the relation of money to the division of labor.
3. If gold and silver could not be used as a measure of value, as a standard of deferred payment, and as a store of value, would they be used as money? Why?
4. What are the monetary units of the following countries: France, England, Germany, Italy, Holland, Spain, Canada, Russia, Mexico, China, Japan, and any other nation in which you may be interested?
5. Explain exactly why the following are not used as money in this country: iron, lead, tin, diamonds, wheat, cotton, platinum.
6. If you buy a radio and give in exchange a note promising to pay for the radio in 60 days, does the note perform a function of money? Explain the similarities and the dissimilarities between a promissory note and money.
7. Suppose everyone were free to coin money. What would be the results?
8. At present all the gold used as money is locked in the vaults belonging to the National Government. Suppose the gold were stolen. What would happen to the value of our paper money if the fact became known? if it did not become known?
9. Explain what a savage, unaccustomed to the use of money and of most of the articles we use, would have to learn before he could use money intelligently in making purchases.

TOPICS FOR SPECIAL REPORTS

1. Money in ancient times.
2. Money in Colonial America.
3. Money in the Confederate States of America.
4. The value of the monetary units of the following countries in terms of our money: England, Germany, France, Japan, China, Mexico, Italy, Russia, Canada, Australia, Spain, Brazil, Belgium, India, Switzerland, Norway, Sweden, and Denmark.
5. The distribution of gold among the nations of the world.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Was the desire for money or wealth the most important reason for the exploration and settlement of America?
2. Is custom more important in determining the acceptability of money than is the intrinsic value of the thing that is used as money?
3. Is gold a better money metal than silver?
4. Is the use of money more instrumental in promoting a division of labor than a division of labor is in promoting the use of money?

CHAPTER 16

THE MONEY WE USE

Do you know how many kinds of money are in use in the United States at the present time? Of course, you know that there are metal coins and paper bills. And probably you can name all of the coins. But there are also seven kinds of paper money listed by the United States Treasury Department. Why do we have so many kinds of paper money? What gives value to each kind of money? Is one kind as good as another?

Most of us would like to be able to answer these questions. It is now our purpose to try to find and to understand the answers.

Standard Money Usually Has Commodity Value. By *standard money* we mean the money in a monetary system upon which the value of other kinds of money is based. Standard money may be gold, silver, or any other kind of commodity, or any combination of money metals. It could even be paper money, if the Government should decide to adopt a paper-money standard.

In modern times gold alone or silver alone has usually been used by commercial and industrial nations as the standard for monetary systems. When one metal is used, the standard is *monometallic*. A few nations have tried to use gold and silver at the same time as standard money by passing laws decreeing that a certain amount of one metal was equal in value for money use to a certain amount of the other metal. When two metals are thus used, the standard is *bimetallic*.

For many years prior to 1933 we had a monometallic monetary standard based on gold. Since that time we have had a managed gold-bullion standard. What is meant by these terms and how we came to adopt our present monetary standard can best be understood by tracing briefly the history of money in the United States since the adoption of the Constitution.

A Bimetallic Standard Was Adopted in 1792. Upon the recommendation of Alexander Hamilton, the first Secretary of the Treasury, the United States adopted a bimetallic standard in 1792.

Although the bimetallic standard was abandoned many years later because it was unsatisfactory, there are some persons who feel that it is better than our present standard. It has been asserted that the troubles the United States encountered in trying to make it work would not arise if all nations adopted bimetallism. The subject, therefore, is likely to be talked about for many years.

Our Experience with Bimetallism Proved Unsatisfactory. When the Government adopted the bimetallic standard, it did so for two reasons. In the first place, many were of the opinion that there was not enough gold in the country to serve the need for money. In the second place, some held that a bimetallic standard would be more stable than a single metal standard. It was contended that, if the market value of one of the metals changed, the value of the other would not be likely to change in the same direction and at the same time. In fact, the values of the two might change in opposite directions, and the effects of the change in the value of each might thereby be offset. In this way, it was said, the value of the dollar would be more stable than if it rested upon the value of either metal alone.

Mint Ratio and Market Ratio. When the Constitution was adopted, we had no national coins. Foreign coins were in circulation, including many Spanish silver dollars. It was estimated that these dollars averaged 371.25 grains of pure silver in weight. As a rule, they could be exchanged for 24.75 grains of gold.

Hamilton therefore concluded that we should adopt a gold dollar containing 24.75 grains of gold and a silver dollar weighing 371.25 grains. The ratio between these two amounts was exactly 15 to 1. In other words, one ounce of gold was worth 15 ounces of silver.

This ratio was established as the *mint ratio*. It meant that the Government would coin into money all the gold and the

silver that people might bring to the mint and that, when the bullion had been made into money, one ounce of gold would buy as much goods as 15 ounces of silver, so long as each metal was used as money.

But we must keep in mind that gold and silver are commodities; that is, they are used for purposes other than money. Like wheat or corn, they can be bought and sold in the market. And if one becomes relatively scarce while the other does not decrease in amount, the price of the one, in terms of the other, will rise.

Thus, if it is customary in the market to exchange one ounce of gold for 15 ounces of silver, and if gold becomes scarce, it is likely that more than 15 ounces of silver will be required to buy an ounce of gold. Hence there is a *market ratio* as well as a mint ratio for the values of gold and silver. That is, there is a price for each metal in terms of the other that is fixed by demand and supply when it is possible to use gold and silver for purposes other than money. The mint ratio may be fixed by the Government, but the market ratio depends upon the demand for and the supply of each of the two metals.

Gresham's Law. If the market price, or ratio, does not agree with the government price, or mint ratio, it is probable that one of the metals of a bimetallic standard will cease to be used as money.

Let us suppose that, when the bimetallic standard was adopted, a suit of clothes could be bought for $10. If the buyer had both kinds of money, he would as soon pay for it in gold as in silver, because the two metals were equal in value both at the mint and in the market. Payment would require 247.5 grains of gold or 3712.5 grains of silver, in the form of coins (that is, 10 x 24.75, or 10 x 371.25).

Suppose, however, that the market price of silver, in terms of gold, rose and that it would therefore require $11 in gold (247.5 plus 24.75 grains) to buy $10 worth of silver. The mint ratio would still remain at 15 to 1. But anyone owing a debt and having both gold and silver in his possession would pay the debt in gold because that metal would be worth less in the market than silver; that is, the gold in $10 worth of gold money would not buy 15 times as much silver in the market. The

creditor could not compel payment in silver. Under these conditions gold would be used to pay debts because the debtor would have the choice of paying in either gold or silver. According to the mint ratio, gold would be overvalued, as compared with the ratio at which it could be exchanged for silver in the market. If gold thus remained overvalued for a considerable time, silver would cease to be used as money, because people would use gold in paying their debts. Silver would eventually disappear from circulation.

On the other hand, if the mint ratio of silver was 15 to 1 and the market ratio was 16 to 1, silver would be overvalued; and it would tend to be used in paying debts. This practice would have a tendency to drive the more valuable money, gold, out of use.

How Gresham's Law Operates

Assume that the mint ratio is 15 to 1; that is, 1 ounce of gold buys 15 ounces of silver at the mint.

When the Market Ratio Is—	Gold Is—	Silver Is—	The Reason for These Effects Is—
15 to 1	Coined	Coined	The two metals have the same values on the market and at the mint.
16 to 1	Not coined—disappears from circulation	Coined	Gold buys more silver on the market than at the mint.
14 to 1	Coined	Not coined—disappears from circulation	Silver buys more gold on the market than at the mint.

A Summary of the Operation of Gresham's Law

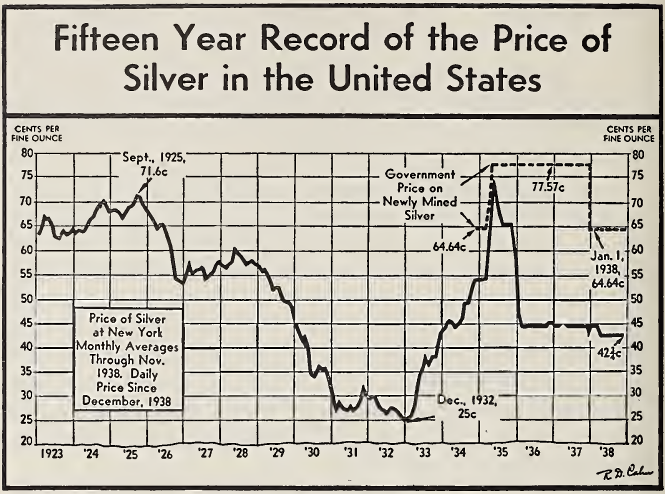
The tendency for an overvalued money to drive a more valuable money out of circulation is known as *Gresham's law*, because Thomas Gresham, a financial adviser to Queen Elizabeth, first explained how the tendency operates. Stated in popular language, Gresham's law means that poor money will drive good money out of circulation.

The Compensatory Principle. It is claimed by those who favor bimetallism that, when the market ratio of one metal becomes higher than the mint ratio, the greater demand for the cheaper metal for use as money and the decrease in the demand for the other because of its high price, will cause the market price of the cheaper metal to rise. This tendency for changes in demand to regulate the ratios of gold and silver is known as the *compensatory principle*. It is in keeping with the principles of demand and supply, for, as we know, the general rule is that the lower the price, the greater the demand, and the higher the price, the less the demand.

It was expected that the operation of the compensatory principle would keep the mint and market ratios of gold and silver equal. Unfortunately, however, there were periods when the supplies of one metal or the other were so great that the influence of the principle was not strong enough to keep the two ratios the same.

Shortly after the mint ratio of 15 to 1 was established in 1792, the production of silver in the world greatly increased, while that of gold declined. Before long the market ratio of the two metals was about 15½ to 1. As a result, it became possible to take 15 ounces of silver to the mint and have it made into money that was equal in value to 15½ ounces of uncoined silver. Thus one could buy 15½ ounces of silver with an ounce of gold or with the money made from 15 ounces of silver. As you can see, here was an opportunity for dealers in silver to make a profit. And since silver was the less valuable money, it was used in place of gold in paying debts.

In order to bring gold back into circulation, the mint ratio was changed in 1834 to 16 to 1. This undervalued silver. That is, the Government said, in effect, that it required 16 ounces of silver to equal 1 ounce of gold; while in the market, it required only 15½ ounces to equal 1 ounce of gold. As might be expected,



Chicago Tribune

The Pre-War Silver Price Record

What would have happened if we had been on a bimetallic standard from 1923 to 1938? Would the compensatory principle have come into operation?

gold came back into circulation, and silver soon began to disappear from use as money. Then, too, in 1848 great deposits of gold were discovered in California. The gold rush of the "forty-niners," together with the discovery of other rich gold mines elsewhere, greatly increased the supply of gold. Silver rapidly disappeared from circulation, and for many years no silver dollars were coined. In order to keep the smaller silver coins in circulation, it became necessary in 1853 to "debase" them by reducing the amount of silver used in making them. After this was done, the silver in the smaller coins was worth less than the fractions of a dollar that they represented, and, for that reason, they continued to be used.

"The Crime of '73." In 1873 the coinage laws were rewritten. In the new statement of the monetary laws no mention was made of silver dollars. Since none had been coined for about twenty-five years, no one objected.

Within a year or two, however, the market price of silver went down and that of gold went up, and silver thus became the cheaper metal. But when silver owners tried to have their metal coined, they found that, in the revision of the coinage laws in 1873, no provision had been made for the coinage of silver dollars. Those who wanted silver coined called the coinage act the "Crime of '73." They charged that there had been a conspiracy to defraud silver owners.

The Bland-Allison Act. The protests of the silver advocates resulted in the passage of the Bland-Allison Act in 1878. This act provided for the purchase of not more than $4,000,000 nor less than $2,000,000 worth of silver a month, the bullion to be coined into silver dollars. The advocates of this act claimed that the increase in the amount of money would help the farmers and the debtors of all classes by raising the prices of farm products.

The Sherman Silver Purchase Act. The purchases of silver by the Government under the Bland-Allison Act did not restore the price of silver. Instead, the price continued to decline as a result of new discoveries of silver ore.

In 1890 the silver owners and those who favored an increase in the amount of silver money succeeded in passing the Sherman Silver Purchase Act. This law called for the purchase of 4,500,000 ounces of silver a month, the bullion to be paid for by issuing paper money. This paper money became known as the Treasury notes of 1890. The act did not require that all the silver purchased be coined.

But silver money was so great in quantity that it tended to drive gold out of circulation. Much gold was exported from the country because people feared the country would be forced off the gold standard and, as a consequence, business would collapse.

The Sherman Act was repealed in 1893. For several years, however, the silver question was bitterly debated. In the presidential campaign of 1896, William Jennings Bryan, the advocate of the adoption of a bimetallic standard with a ratio of 16 to 1, was defeated by William McKinley, the advocate of the gold standard. In 1900 the passage of the Gold Standard Act definitely placed the country on the gold standard.

Later Silver Legislation. From time to time the silver question has been revived by those who want "to do something for silver." By acts of Congress in 1933 and 1934, the Secretary of the Treasury was directed to buy enough silver to bring the proportion of our gold to silver money to 3 to 1. This legislation meant that eventually gold should equal 75 per cent and silver 25 per cent of the total amount of both gold and silver used as money. The Government did not, however, adopt bimetallism.

Conclusions as to Bimetallism. From 1792 to 1873, a period of eighty-one years, this country was legally on a bimetallic standard. During that time the mint ratio and the market ratio of gold and silver were seldom equal. As a result, sometimes gold was the real standard; at other times silver was the real standard.

From 1878 to 1893 the Government tried to raise the price of silver by buying silver in the market. This effort failed to accomplish its purpose and had to be abandoned. In other words, our experience with bimetallism was not satisfactory.

What Is Meant by the "Gold Standard"? To explain exactly what is meant by this expression, we may say that the gold standard means:

1. *That a unit of gold is the measure of value for goods, services, and other money.* Every country that adopts the gold standard designates the amount of gold that is to serve as the unit of value. The unit is given a name, as *dollar, pound sterling, franc,* or *mark.*

2. *That the government will coin an unlimited amount of gold bullion.* As long as the nation is on the gold standard, anyone may have gold coined into money by paying the cost of coinage, or brassage. If silver is also used for money, the government buys the amount that is needed. Thus the amount of silver that is made into money is limited.

3. *That all other money can be exchanged for gold at its face value.* As long as the nation is on the gold standard, anyone may take his other kinds of money to a bank and have them exchanged for gold.

4. *That gold is legal tender.* This means that if you owe a debt, you may offer to make payment in gold. If the creditor refuses to take the gold, he cannot claim that you have not made an acceptable offer to pay the debt. If payment were offered in money that is not legal tender, he could claim that a satisfactory offer to pay the debt had not been made, and he could bring suit in court for collection of the debt. Of course, when a country is on the gold standard, other forms of money may also be used as legal tender.

5. *That people are free to own and use gold as they do any other commodity.*

A Managed Gold-Bullion Standard Was Adopted, 1934. The United States was on the gold standard for many years. The law was not clear from 1873 to 1900 but, with the passage of the Gold Standard Act in the latter year, there was no doubt as to our monetary standard from 1900 to 1933.

In 1929 business the world over suffered a severe decline. Conditions grew worse for several years. By 1932 fewer than one-half dozen important nations remained on the gold standard. During the early months of 1933 a general money panic seemed to seize the people, and they began to convert their money and bank deposits into gold and to hoard it. At the same time, poor business conditions made it difficult for many banks to remain open.

Because of the large number of bank failures and the growing demand for gold for hoarding purposes, the President of the United States declared a bank holiday in 1933, by which all national banks were closed in order to give people time to recover from their panic and to enable the Federal Government to try to do something to help the banks. All persons owning gold or gold certificates were ordered to turn them in to the Treasury of the United States and to receive in exchange other kinds of money. The President declared that all public and private debts could be paid with other kinds of money, even though payment in gold had been promised. Thus we "went off the gold standard."

In 1934 the Gold Reserve Act was passed by Congress. This act provided that:

1. All gold held by Federal reserve banks should be transferred to the Treasury of the United States and that in exchange the banks might receive gold certificates, which, however, could not be redeemed in gold. The certificates could be used only by the banks in dealing with the Government or with other Federal reserve banks.
2. Coinage of gold should be forbidden and that all gold coins owned by the Government should be melted into bars.
3. With the approval of the Government, gold in limited quantities could be purchased by private individuals and concerns for manufacturing uses. Also under certain conditions gold could be bought and shipped to foreign countries.
4. The President could reduce the weight of the dollar by not more than 50 per cent of its former weight.

Immediately after the passage of the act, the President declared the weight of the gold dollar to be 13.71 grains instead of 23.22 grains. This means that the gold in the new kind of dollar is only 59.06 per cent as much as it was before. This reduction is spoken of as *devaluation.*

As a result of the devaluation of the dollar it is said that the United States Government gained more than two billion dollars in gold. This means that since the weight of the dollar was made less, the number of dollars that could be made from the gold held by the Government was greater, although the actual amount of the gold was the same.

The Effects of Devaluation. One of the objects in devaluing the dollar was to raise prices. The Government believed that, if prices increased, people could sell goods at higher prices and thus pay their debts more easily; businessmen would be able to make more profits; production would be stimulated; and recovery from the depression would be hastened. After we left the gold standard and the dollar was reduced in value, prices began to rise. Production of consumer goods increased, and many corporations were able to show marked increases in profits. There was some increase in employment and in wages. It is impossible, however, to say how much of the change in

business conditions was due to the abandonment of the gold standard and to the reduction in the weight of the dollar.

Our Managed Gold-Bullion Standard. The dollar is now stated in terms of a certain number of grains of gold, 13.71. But gold is not coined for use as money, and none of the money in use can be redeemed or converted into gold. It is said, however, that the security back of our other kinds of money is a large stock of gold that is owned by the Government. In making certain payments to foreigners, citizens and corporations may purchase gold bullion and send it abroad. And the Government will buy all the gold offered, payment being made in other kinds of money.

What Is Fiat Money? Some persons question the necessity for using either gold or silver as standard money. They state that the principal use of money is that of a medium of exchange. They say, therefore, that paper money would be just as good as any other. They argue that the Government should print what money is needed and thus should avoid the difficulties of a gold or any other metallic standard. Such money could not be converted into gold, for gold would not be standard. It would be *fiat money* because it would circulate by the decree, or fiat, of the Government.

Fiat, or inconvertible paper, money would be satisfactory (1) if people would accept it in transactions, (2) if the quantity printed could be controlled, and (3) if all nations would adopt a uniform fiat money standard. But custom is strong; and although they may never see it, people like to feel that their paper money is backed up by gold. Moreover, the printing of money by a government without any relation to the amount of the gold reserve has always proved disastrous to the nations that have tried the plan. As long as money is based on gold, governments are, as a rule, not likely to print so much money as they would if the paper money were not related to gold.

People do not like to pay taxes. Hence, rather than impose more taxes, a government that has the right to print irredeemable money may be tempted to print money with which to carry on its work.

Germany and Paper Money. The experience of Germany in 1923 will always stand as an example of what may happen when a government starts printing inconvertible paper money. In 1914, before World War I, the total amount of currency in circulation in Germany was 5,741 million marks, a mark being worth at that time about 24 cents in our money. By January, 1923, the number of marks in circulation had increased to 1,336,500 million, and before the end of that year the number had grown to the enormous sum of 497,000,000,000,000 million.

The savings of the people became practically worthless. Suppose, for example, a family had been able to save 10,000 marks, which would have been equivalent to about $2,400 in our money. After prices had risen in 1923, the total amount of savings would not have been sufficient to pay for a package of chewing gum.

This rise in prices was a form of price inflation. It was due primarily to an increase in the amount of money issued and not to a larger demand for goods and services. As the amount of money issued by the German government increased, its value, or purchasing power, decreased.

Reasons for Issuing Paper Money in Germany. During the war the German government borrowed money from the people. Consequently the war left the nation burdened with debt. Furthermore, as in nearly all the other countries, prices had more than doubled. Matters were made still worse when a debt of 132,000,000,000 gold marks, or about $33,000,000,000, was imposed upon Germany as reparation for damages done to certain of the countries that had opposed her in the war. A part of the debt claimed by France was to be paid in the form of raw materials and by the rebuilding of houses that had been destroyed by the war. Although practically all reparative payments were canceled later, for several years Germany was forced to pay great sums to other countries in the way of reparations. In addition she had to raise funds with which to carry on her own government. Even if Germany had been willing to pay, it is doubtful whether she could have continued to do so.

Naturally when taxes were increased for the purpose of raising money to meet the payments for reparations and the expenses of government, the German taxpayers protested. Under the circumstances the government resorted to borrowing more and more from the people and to printing money with which to meet its obligations at home and to buy the materials needed to make reparation settlements. As more funds were borrowed and more money was issued, prices increased; and it became increasingly necessary to borrow still more funds and to issue larger amounts of money. And so the vicious circle continued. By the end of 1923, thirty-three paper mills were required to supply the paper needed in printing money.

Of course, the ridiculous situation could not continue forever. The only way out of the difficulty was to revalue the mark. This was done by establishing a new mark and valuing it at the same amount in gold as the old mark. The old marks were then redeemed in new marks at the rate of 1,000,000,000,000 for 1. In other words, $240,000,000,000 worth of the old marks could be exchanged for about 24 cents in the new money. People who had lent money to the government got nothing for the bonds that they held.

Our Experience with Fiat Money. In 1862 the United States Government was authorized by Congress to print paper money with which to carry on the war. The people thought it would be better to print the money than to pay taxes. So, within a short time, several hundred million dollars of United States notes, or "greenbacks," had been printed. In 1864 there were $431,000,000 worth of these notes in circulation.

As soon as the Government began issuing the greenbacks, Gresham's law came into operation. The paper notes came into use, and gold and silver disappeared from use. In business transactions the paper dollar was the actual standard of value. The value of the paper dollars fell to about 35 cents in terms of gold. In 1879 the Government began to redeem the paper notes in gold. Naturally when the redemption of these notes began, the value of the greenbacks rose until it was equal to that of gold. But from 1863 to 1879 the operation of Gresham's law placed this country on a paper standard, although legally it was on a bimetallic standard.

What Is the Nature of Each of Our Kinds of Money? We have many kinds of money in the United States, some of which are coins and the others paper money. Although all of these kinds are not in circulation for use by individuals, we cannot understand our complete monetary system unless we are familiar with each kind of money that we have.

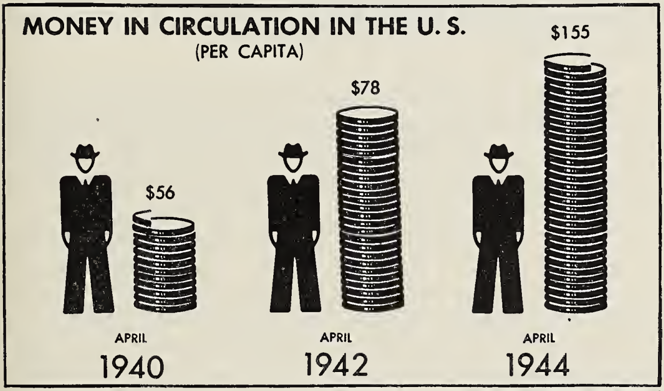
UNITED STATES MONEY—JULY 31, 1944

Kind of Money	Total Amount
Gold	$20,995,928,323
Gold Certificates	(18,876,923,239)
Standard Silver Dollars	494,337,327
Silver Bullion	1,520,133,653
Silver Certificates	(1,805,764,924)
Treasury Notes of 1890	(1,153,572)
Subsidiary Silver	742,733,893
Minor Coins	279,049,144
United States Notes	346,681,016
Federal Reserve Notes	19,746,743,285
Federal Reserve Bank Notes	599,739,499
National Bank Notes	126,729,319
Total July 31, 1944	44,852,075,459
Comparative totals:	
June 30, 1944	$44,805,501,044
July 31, 1943	41,279,168,028
October 31, 1920	8,479,620,824
March 31, 1917	5,396,596,677
June 30, 1914	3,797,825,099
January 1, 1879	1,007,084,483

NOTE: There is maintained in the Treasury—(i) as a reserve for United States notes and Treasury notes of 1890—$156,039,431 in gold bullion; (ii) as security for Treasury notes of 1890—an equal dollar amount in standard silver dollars (these notes are being canceled and retired on receipt); (iii) as security for outstanding silver certificates—silver in bullion and standard silver dollars of a monetary value equal to the face amount of such silver certificates; and (iv) as security for gold certificates—gold bullion of a value at the legal standard equal to the face amount of such gold certificates. Federal Reserve notes are obligations of the United States and a first lien on all the assets of the issuing Federal Reserve Bank. Federal Reserve notes are secured by the deposit with Federal Reserve agents of a like amount of gold certificates or of gold certificates and such discounted or purchased paper as is eligible under the terms of the Federal Reserve Act, or, until June 30, 1945, of direct obligations of the United States if so authorized by a majority vote of the Board of Governors of the Federal Reserve System. Federal Reserve banks must maintain a reserve in gold certificates of at least 40 percent, including the redemption fund which must be deposited with the Treasurer of the United States, against Federal Reserve notes in actual circulation. "Gold certificates" as herein used includes credits with the Treasurer of the United States payable in gold certificates. Federal Reserve bank notes and National bank notes are in process of retirement.

Gold Bullion. After the Government went off the gold standard in 1933, very few gold coins were left in circulation. People were required to exchange their gold coins and gold certificates for other kinds of money. Now all monetary gold is held by the Government in the form of bullion.

In the early years of the Government, gold was coined in denominations of $2.50, $4, and $10. Later, only $5, $10, and $20 pieces were coined. After 1837 the coins weighed 25.8 grains to a dollar, 2.58 grains being alloy in order to give the coins hardness. There was no limit to the amount of gold that might be coined, and everyone was free to bring gold bullion to the mint to be made into money. Now, although the Government will buy all the gold that is offered to it, gold is no longer coined.



PICTOGRAPH CORPORATION

Gold Certificates. Before 1933 the Government issued gold certificates, which could be redeemed in gold coin. Since the gold supply now belongs to the Government, gold certificates are held by the Treasury or by the Federal reserve banks; none are used by the public.

Silver Coins. The silver dollar weighs 412.5 grains, 41.25 grains being alloy. Most of the silver acquired by the Government is held in the Treasury in the form of bullion. In 1944 there were about one half billion "standard silver dollars,"

most of which were also held in the Treasury. The expression "standard" is a relic of the time before 1873, when we were on a bimetallic standard and both gold and silver were standard money.

Silver is coined into subsidiary coins of one-half, one-quarter and one-tenth dollars. The coinage of silver is not free, that is, no one is free to take silver bullion to the mint and have it made into money. Since 1900 silver has been purchased by the Government as it has been needed. As we have seen, in 1934 Congress passed an act that required the Government to increase its purchases of silver.

Silver Certificates. Comparatively few silver dollars are in circulation. The silver is kept in the Treasury, and silver certificates are issued, the greater number being in denominations of $1, $2, $5, and $10. These certificates are redeemable in silver dollars.

Minor Coins. The minor coins consist of the nickel and the one-cent piece. The nickel is composed of 25 per cent nickel and 75 per cent copper. The one-cent piece is composed of 95 per cent copper and 5 per cent tin and zinc. These coins are made by the Government as business demands them.

In 1943 the increased need for fractional coins occasioned by the great amount of business and the use of copper for war purposes, led to the coinage of one-cent pieces made of steel with a zinc coating. Begun in February of 1943, the practice was discontinued by the end of the calendar year. The output of the zinc-coated-steel one-cent pieces had a money value of $10,938,386.70.

United States Notes, or Greenbacks. Any kind of paper money is frequently called a greenback because of its usual color. But, in reality, the term *greenback* is applicable to only one kind of paper money—the United States notes. The way in which these notes originated has been explained on page 255. In 1875 a law was passed to provide for their redemption in gold on January 1, 1879.

It had been decided, however, not to remove all the greenbacks from circulation because it was thought that, by doing so,

Burning Worn and Mutilated Money

When paper money becomes worn and mutilated, it is sent by banks to the United States Treasury, where the bills are recorded and then burned.

United States Treasury Department

prices would fall too low. Hence it was decided to keep in circulation the amount outstanding on May 31, 1878, which was $346,681,016. The same amount of United States notes remains in circulation today. These notes are now secured by a permanent deposit of $150,000,000 in gold, plus the promise of the Government. Whenever the notes are redeemed, they are reissued.

National Bank Notes. The National Bank Act was passed in 1863. This law provided for the organization of banks under a Federal charter. Banks so organized were required to buy certain amounts of government bonds, the amount depending upon the size of the bank. Some much-needed money was obtained by the Government in this way. The banks were given the right to issue national bank notes and were required to leave the government bonds on deposit with the Treasurer of the United States as security that the notes would be redeemed. National bank notes are acceptable anywhere in the country, and for a long time they served as an important part of our monetary system. In 1935 the Government redeemed the bonds that the banks had on deposit with the United States Treasury, and the issuance of national bank notes was discontinued. A

few notes, however, still remain in circulation. These are redeemed when presented to banks. Within a short time they will cease entirely to be used.

Treasury Notes of 1890. As we have seen, by the provisions of the Sherman Act of 1890, the Government was required to purchase certain quantities of silver. To pay for the silver, the Government issued notes similar to greenbacks. They are the promissory notes of the Government and are payable "in coin." Until 1933 they were, in practice, ordinarily redeemable in gold.

Federal Reserve Currency. In an attempt to improve the banking system, Congress passed the Federal Reserve Act in 1913. The purposes of the Federal Reserve System were several, but only one need be considered at this point.

Under the former banking system the amount of money had been limited to the kinds described in the preceding paragraphs. It was felt, however, that the amount of money should be elastic, that it should be possible for the amount to increase when business needs required more money and to decrease when the same amount of money was not needed. The Federal Reserve System therefore provides that a commercial bank belonging to the System may take its commercial paper (the promissory notes and other kinds of written promises and orders to pay that arise from business transactions and that have been received from customers of the bank) to the Federal reserve bank in the district to which it belongs and may borrow money or credit on the paper. This procedure is called *rediscounting commercial paper.* In exchange for the commercial paper the Federal Reserve Bank may increase the amount of the deposit of the commercial bank, or it may give the commercial bank Federal reserve notes.

As additional security for the redemption of the Federal reserve notes, each Federal reserve bank must ordinarily keep a reserve of at least 40 per cent in gold behind the notes that it has issued to borrowing banks. Thus the money issued by a Federal reserve bank has behind it (1) the promises of those who signed the rediscounted commercial paper; (2) the promise of the local bank; (3) the credit of the United States, because the notes

are obligations of the Government; and (4) at least a 40 per cent gold reserve. Federal reserve banks, however, do not keep the gold itself on hand; they merely hold certain amounts of gold certificates, which can be used as money by the reserve banks in dealing with the Federal treasury or with other reserve banks. All monetary gold is held by the Government.

When the member banks borrow from the Federal reserve bank in their district, the amount of money in circulation in the country is increased. But when the loans are repaid, the amount in circulation is decreased. The system therefore helps to make the amount of money elastic.

Federal reserve notes are issued in denominations of $5, $10, $20, $50, $100, $500, $1,000, $5,000, and $10,000. If you consult the table on page 256, you will see that Federal reserve notes constitute the greatest amount of any money in circulation.

In addition to the Federal reserve notes the Federal reserve banks have issued a small amount of Federal reserve bank notes.

Kinds of Money in the United States

Kind of Money	In Circulation	Not in Circulation
Paper Money:		
Gold Certificates		√
Silver Certificates	√	
Greenbacks	√	
National Bank Notes	√[1]	
Treasury Notes of 1890	√	
Federal Reserve Notes	√	
Federal Reserve Bank Notes	√[1]	
Metal Money:		
Gold bullion		√
Silver bullion		√
Silver Coins	√	
Minor Coins	√	
	[1]In process of retirement	

A Summary of Our Kinds of Money

The amount of these notes is negligible. Few, if any, of the notes are issued at the present time. They were issued in denominations of $1, $2, $5, $10, $20, and $50.

QUESTIONS ON THE CHAPTER

1. Why do we use so many kinds of money in the United States?
2. How does a monometallic standard differ from a bimetallic standard?
3. Distinguish between mint ratio and market ratio.
4. When two metals are used for money, what determines the market price of each?
5. How does Gresham's Law operate?
6. What was the "Crime of '73"? Why was it so called?
7. What three important acts relating to silver were passed by Congress since 1875?
8. What is meant by saying that a nation is on "the gold standard"?
9. What was the Gold Reserve Act of 1934?
10. Why did businessmen fear inflation after the passage of the Gold Reserve Act?
11. How much was the dollar devalued in 1934?
12. How was this devaluation supposed to affect prices?
13. Is the use of fiat money desirable? Why, or why not?
14. What was Germany's experience with paper money after World War I?
15. Why did Germany issue so much paper money in 1923?
16. Are greenbacks convertible?
17. List the kinds of money in the monetary system of the United States.
18. How was the Federal Reserve System supposed to furnish us with an elastic currency?
19. What is the meaning of each of the following terms?

    (a) **bimetallic standard**
    (b) **Bland-Allison Act**
    (c) **compensatory principle**
    (d) **"Crime of '73"**
    (e) **devaluation**
    (f) **fiat money**
    (g) **gold standard**
    (h) **greenback**
    (i) **Gresham's law**
    (j) **market ratio**
    (k) **mint ratio**
    (l) **monometallic standard**
    (m) **rediscounting commercial paper**
    (n) **Sherman Silver Purchase Act**
    (o) **standard money**

APPLICATIONS OF THE CHAPTER

1. Report on any article or news item that you have read recently that concerns any of the kinds of money discussed in the chapter.
2. Examine as many kinds of money as you can, and identify them according to the discussions in the chapter.
3. Compare the security behind each of our kinds of money.
4. Why did some kinds of our money formerly possess the quality of legal tender while others did not? Why was all money declared legal tender when we went off the gold standard?
5. Would Gresham's law come into operation if we adopted bimetallism? Why? Discuss.
6. Explain why some kinds of money have value as commodities, while other kinds possess no commodity value. Is it necessary that at least one kind of money in a monetary system have commodity value? Explain.
7. Suppose that we were to adopt a bimetallic standard with a mint ratio of 16 to 1, silver being the cheaper metal. Do you believe that the price of silver would rise? Would the forces of demand and supply cause it to rise until the market ratio would equal the mint ratio? If the market ratio did equal the mint ratio, would the ratios remain equal? Why?
8. Explain what is meant by the terms *undervalued* and *overvalued* in a discussion of bimetallism. What is the result of each condition when a country is on a bimetallic standard?
9. What classes of people in Germany suffered most during the inflation period of the early 1920's? Why?
10. How does borrowing by a government tend to create inflation? Suppose that the Government of the United States borrowed $10,000,000,000, which was not to be repaid for one hundred years, and spent the entire amount within one year for roads, schools, battleships, forestry service, and so forth. What would be the effect on prices? Which prices would be affected? Would the prices of goods increase because the goods had become more valuable? Suppose the Government simply printed the same amount of money, instead of borrowing it, and used it for the same purposes. What would be the effects?
11. People do not like to pay taxes. Why, then, does not the Government print the money it needs, and thus relieve the people of taxes?
12. Suppose the content of the gold dollar should be reduced 50 per cent. Why would not prices immediately double? What would be the effect on the prices that foreigners would pay for our goods? What effect would this condition have on our exports? on our imports?

13. Would we be able to get along as well if there were only two or three kinds of money? Discuss.
14. Consult reports of the United States Department of Labor or other sources and find out whether devaluation of the dollar affected the cost of living.

TOPICS FOR SPECIAL REPORTS

1. The establishment of our monetary system in 1792.
2. The purchase of gold and silver under the Franklin D. Roosevelt administration.
3. The greenbacks.
4. Our monetary history since 1933.
5. The effect that going off the gold standard in 1933 had on our foreign trade.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is the gold standard the best basis for our monetary system?
2. Would international bimetallism be successful?
3. Could bimetallism be adopted without upsetting the prices of goods?

CHAPTER 17

CREDIT AND COMMERCIAL BANKS

It is not always necessary to have money in order to buy goods. In fact, it has been estimated that money is employed in only about 10 per cent of the total of all business transactions. Instead of money, credit is used in most cases.

Credit Is Purchasing Power. We may define *credit* as the ability to obtain a thing of value in exchange for a promise to pay for it at some time in the future. Therefore when one buys groceries with the understanding that he will pay for them at the end of the month, he is using his credit with which to obtain goods. When a businessman borrows from a bank, he gives his written promise to pay the bank a certain number of dollars on or by a certain date. In exchange for this promise the bank either gives the borrower a sum of money or places the amount to the credit of his account. If the latter is done, the borrower can withdraw any part of the amount in money or transfer it to someone else. Hence the borrower at a bank obtains purchasing power in exchange for his promise to pay the bank at a later date.

Credit depends upon the belief that the buyer or borrower will be able to make payment at the time agreed upon and that he will be willing to pay. Confidence as to the willingness and the ability to pay is the essential ingredient of credit. Willingness to pay depends upon the character of the debtor. Ability to pay involves two other factors. One of these is personal and refers to the individual's ability to run his business successfully. The other factor is impersonal and refers to the property which the individual owns that may be taken by the creditor by means of a legal process to satisfy the debt.

There Are Different Kinds of Credit. Credit is used by various kinds of persons and concerns to secure goods and funds

for different purposes. For this reason we often hear references to different kinds of credit, such as personal or consumer credit, commercial or bank credit, investment credit, agricultural credit, and possibly others.

Personal or *consumer credit* is credit that is used for the purpose of obtaining goods or funds for the satisfaction of personal wants. The purchase of groceries, clothing, and articles for the home, or borrowing from a bank in order to pay for such things are illustrations of the use of personal credit. *Installment credit,* which is used to obtain goods for personal consumption, is a form of personal or consumer credit. *Commercial* or *bank credit* refers to loans made by banks to business concerns on relatively short periods of time, say from thirty to ninety days. Such loans are used for the payment of wages, the purchase of merchandise, and other operating expenses. *Investment credit* is used to obtain funds for long periods of time for the purchase of land and capital goods. *Agricultural credit* is used by farmers for the purchase of agricultural land, the erection of farm buildings, the purchase of livestock, and the marketing of crops.

Most of us who are not business men or women have had more experience with personal credit than we have with the other kinds of credit. No doubt you have bought articles that you did not pay for until you received your allowance or until you had earned the money afterward. And no doubt you know of purchases on credit of articles for use in your home made by your mother and father. In this chapter we shall be concerned only with personal and commercial credit.

Ewing Galloway

Farmers Make Use of Banks

The bank deposits by farmers help to create agricultural credit.

Charge Accounts Have Advantages and Disadvantages. A charge account is a common form of consumer credit. When one buys goods on a *charge account,* he obtains the goods at the time and pays for them later, usually during the first part of the following month.

Advantages of Charge Accounts. Many persons feel it is always better to pay cash for what they buy, if it is at all possible to do so. They say that by paying cash, they are able to buy at lower prices, to know just how they stand financially, and that they will buy more carefully.

A great many others, however, feel that the use of charge accounts has these advantages: (1) charge accounts are convenient, because the bother of paying for small purchases at the time is avoided; (2) buyers are able to obtain and use goods before they have the money with which to pay for them; and (3) in some cases, merchants give charge customers who pay their bills promptly more and better service.

Disadvantages of Charge Accounts. On the other hand, there are two disadvantages that are sometimes urged in criticism of buying on account. In the first place, when many people buy on account, they are sometimes careless in the selection of what they buy. The explanation for this carelessness is that merchants find it difficult to refuse to accept goods that are returned because they are not satisfactory. Moreover, because they do not have to make payment at the time, many persons seem unable to resist the temptation to buy more goods than they would if they paid cash.

In the second place, it is pointed out that everyone has to pay more for what he buys because of the expense of maintaining charge accounts. Selling on account involves a great deal of bookkeeping; the mailing out of monthly statements; in some cases, the carrying on of investigations of the credit standing of customers; and other clerical expenses. Also the losses due to uncollectible accounts constitute an expense. In order to get back the amount of all these expenses, the merchant must add enough to the selling prices of some or all of his goods to cover the amount of the expenses during the year.

Many Articles Are Bought with Installment Credit. Consumers buy a great many goods on the installment plan. That is to say, they obtain possession of the goods and agree to make stipulated payments at stated intervals of time until the full purchase price has been paid. Installment credit is most widely used in the purchase of the more durable consumers' goods, including automobiles, household appliances, and furniture, although it is sometimes used in the purchase of nondurable consumers' goods.

An installment purchase differs from a purchase on a charge account in several ways. In the first place, as we have just said, installment buying is largely confined to durable consumers' goods, while both durable and nondurable consumers' goods are bought on account. In the second place, the title to a good sold on the installment plan usually does not pass to the buyer until final payment has been made, which is not the case when goods are bought on account. If the customer fails to meet his payments, the seller may take possession of, or "repossess," the goods, in which case the buyer loses the amount he may have paid. In the third place, goods bought on the installment plan are paid for by means of a series of payments, whereas several purchases of goods bought on account are paid for in one lump sum. And, in the fourth place, customers who buy on the installment plan nearly always have to pay interest, which is often called a *carrying charge*.

In many cases the cost of goods bought on the installment plan is much more than when bought for cash or on account. The reason for this is that the seller usually charges interest on the unpaid balance or on the total amount of the account. In addition he adds enough to the price of the article to cover bookkeeping costs and other expenses, including the expense of investigating the credit standing of the customer; the increased expense of collecting from "slow pay" customers; the cost of repossessing and reconditioning goods that are not paid for by some buyers; losses in resale prices of repossessed goods; insurance on goods in the hands of customers who have not made final payments; and perhaps other expenses.

Sometimes it is stated that the carrying charge is "only 6 per cent," which sounds very reasonable. Actually, however,

the carrying charge represents much more than 6 per cent. For example, suppose the installment price is $120 plus 6 per cent, or $7.20, and that the terms call for 12 installment payments of $10 each. You can see that the $7.20 is calculated on the total amount of $120. But the buyer does not owe the total amount for twelve months. In fact, during the last month before the final payment he owes only $10. Therefore the average amount of his debt during the year is only $60. Then $60 divided into $7.20 gives the rate of the carrying charge on the average amount of the debt, which is 12 per cent.

Advantages of Installment Buying. Installment buying may have one or more of the following advantages: (1) the buyer is able to obtain the possession and the use of an article before he has accumulated the amount of the full purchase price; (2) installment buying is a form of saving; (3) it is a convenient method for the customer; (4) many goods bought on the installment plan "pay for themselves" because they save expenses, which is a claim made by sellers of such articles as washing machines and refrigerators; (5) installment buying makes it possible for families to "spread out" expenditures and thus budget expenses more satisfactorily.

The Disadvantages of Installment Buying. On the other hand, installment buying may have several serious disadvantages. It has been asserted that (1) installment purchases cost more than when purchased for cash or on account; (2) people frequently overbuy and become too heavily burdened with debt; and (3) many families buy so many things on installment that they cannot afford real necessities of many kinds.

Which Are More Important—the Advantages or the Disadvantages? The truth of the matter is that there is some justification for each of the claims as to the advantages and the disadvantages of installment buying. For example, it is sometimes very desirable for a family to buy a home on the installment plan. On the other hand, there are cases where individuals and families have gone into debt too heavily because it was easy to use installment credit.

Early in World War II, the Government laid some important restrictions on installment sales in an attempt to discourage people from buying things they did not really need. These restrictions were a part of the general plan to control prices.

Commercial Banks Deal in Credit. One of the main functions of commercial banks is to provide credit for use by business men and women. Therefore in order to understand how credit functions as a medium of exchange in the business world, it is necessary for us to learn more about the subject of commercial banking. Here we enter upon one of the most interesting and important subjects in the field of economics.

We have seen how credit may be a convenient method of obtaining goods for personal use. If, however, a retailer allows you to buy goods on account, and if he sells a great deal of goods in this way, he will probably have to borrow money with which to pay for the goods that he buys from wholesalers. If he does not have the money and does not borrow it, he will have to ask for credit from the wholesalers. If the wholesalers sell on account, they also will probably have to borrow from their banks or to ask for credit from manufacturers. As a matter of fact, the retailer, the wholesaler, and the manufacturer do borrow large amounts from banks.

In reality, however, we should not say that they borrow money. What the bank ordinarily does is to lend purchasing power in the form of credit. For example, if a merchant wants to borrow approximately $1,000, he makes out his note for that amount. The bank deducts in advance the interest, which it calls discount, and credits the merchant's account for the balance. Thus, if the loan is for sixty days and the interest rate is 6 per cent, the amount of the interest is $10. The bank then credits the merchant's account for the balance, $990.

The merchant will then be able to write checks to the amount of $990. These checks can be used to pay for goods purchased from wholesalers and to pay other accounts. In the meantime the merchant will sell goods and receive money in payment for them. At the end of sixty days the merchant pays his note for $1,000 at the bank either in money or checks that

A Big City Bank

The simple arrangement of this banking floor makes for speedy service.

Chase National Bank

he has received from others. Thus credit serves the purpose of a medium of exchange quite as well as, or even better than, money.

Where Do Banks Get the Money or Credit They Lend? We can best answer this question by describing briefly the organization and operation of a bank.

A *commercial bank* is usually a corporation. It receives its charter either from the state in which it is located or from the National Government. If it gets its charter from the state, it is a *state bank;* if, from the National Government, it is a *national bank.* In most respects the methods of organization and the services of both kinds of banks are alike.

Organization and Operation. Let us say that a bank has received its charter and that it has a capital stock of $100,000, all of which has been sold and paid for in cash. We can then represent the condition of the bank as follows:

Assets		Proprietorship	
Cash (Paid in by stockholders).......	$100,000	Capital Stock (Owned by the stockholders)	$100,000

The bank must have a place of business and equipment with which to carry on its operations. Let us say, therefore, that it rents a building and buys a vault, desks, and other equipment for $25,000. The condition of the bank is then:

Assets		Proprietorship	
Cash ($100,000 minus $25,000)	$ 75,000	Capital Stock	$100,000
Equipment (Vault, etc.)	25,000		
	$100,000		$100,000

Since the bank is owned by responsible men who are well known in the community, many persons will probably desire to deposit money, with the privilege of withdrawing the money by check. Suppose, therefore, that during the first week the deposits of cash amount to $15,000. The condition of the bank is then as follows:

Assets		Liabilities	
Cash ($75,000 plus $15,000)	$ 90,000	Deposits (Owed to depositors)	$ 15,000
		Proprietorship	
Equipment	25,000	Capital Stock	100,000
	$115,000		$115,000

The bank has $15,000 more than was supplied by the owners, and it owes the depositors that amount.

Demand and Time Deposits. When people put money into a bank, they do so with the idea of allowing at least part of it to remain for several days or possibly for months. The bank therefore becomes indebted to the depositors for the amount of the deposits. The term *deposits* in the preceding statement therefore represents the amount that the bank owes the depositors.

If money is deposited with the understanding that it may be withdrawn at any time without previous notice, the deposit is called a *demand deposit.* But if the depositor wishes to leave his money with the bank in a savings account, the bank will pay a small rate of interest for the use of the money. In case the depositor desires to withdraw his savings deposit, the bank reserves the right to receive several days' notice. Most of the savings deposits are invested by the bank in some kind of interest-bearing notes or other commercial paper or securities.

Therefore, when the depositor wishes to withdraw his deposit, it might be that the bank would desire several days in which to sell some of its investments and to obtain the money with which to pay the depositor. Usually, however, savings deposits may be withdrawn at any time. Deposits made under these conditions are called *time deposits.*

The Creation of Bank Credit. The fact that people do not withdraw money from the bank as soon as they make their deposits, or as soon as they receive a loan from the bank, is of great importance. It enables the bank to agree, with safety, to pay out more money than it has in its possession.

Suppose that on June 1 William Jones, a merchant, wishes to borrow $500 for thirty days from the bank previously used as an illustration. If his character is good and his business promising, the bank will let him have the money or credit and will charge interest for the time of the loan. Ordinarily under these conditions the merchant will not take the money but will be content to leave the amount of the loan in the bank and to draw checks against it. In this example we shall ignore the discount, or interest. Immediately after the loan is made, the condition of the bank is:

ASSETS		LIABILITIES	
Cash	$ 90,000	Deposits ($15,000 plus Jones's deposit)	$ 15,500
Equipment	25,000		
		PROPRIETORSHIP	
William Jones—Note Receivable (Called "Loans and Discounts")	500	Capital Stock	100,000
	$115,500		$115,500

Other businessmen will borrow from the bank. At the same time many will make daily deposits of the cash receipts from their sales and collections. As the notes of the bank's customers fall due, they will be paid.

Most bank loans are made for short periods of time, usually from fifteen to ninety days. The banker, therefore, by properly timing the dates of the loans that he makes, can safely expect to have about as much money coming into the bank in the way of

deposits of cash and of payments of loans as he agrees to pay out on checks drawn by customers. Experience has shown that, because of the facts indicated above, intelligent bankers can, under ordinary business conditions, safely lend out several times as much credit as they have money on hand.

Unfortunately sometimes during periods of business prosperity, some banks extend too much credit. When a great many banks do this, the creation of so much credit helps to produce an unhealthy business boom. As a result many people become so deeply involved in debt that they cannot meet their financial obligations when they fall due.

Of course, at any time if all those who have a right to draw checks on the bank were to demand payment, the bank would have insufficient cash to meet the demands of the depositors. But the depositors withdraw their deposits by checks as funds are needed. As borrowers' notes fall due and are paid, about as much money is coming into the bank as is going out.

Sometimes, however, confidence in the ability of the bank to pay checks drawn by depositors is shaken and a "run" on the bank develops. That is to say, everyone attempts to withdraw his deposits in the form of cash. In such a case, unless the bank can borrow money from some source, it has to close its doors. Banks that are capably managed can usually borrow amounts they may need from a Federal reserve bank or from other commercial banks.

From the preceding simplified illustration, it can be seen that the function of a commercial bank is to lend its credit to individuals or businesses in exchange for promises to repay the loans. Thus it may be said that the commercial bank is a manufacturer of commercial credit, the personal credit of the depositors being the raw material from which bank credit is made.

Banks Keep Reserves of Money. It is apparent that a bank must keep on hand a sufficient amount of money with which to pay the checks that will likely be drawn on it. This amount of money is known as its *working reserve.* How much this reserve should be depends upon the experience of the bank. For example, if the bank finds that it can meet ordinary demands by keeping on hand cash amounting to 10 per cent of its deposits,

THE NATIONAL BANK OF PATTON
Patton, Ohio
STATEMENT OF CONDITION JUNE 30, 194–

ASSETS		LIABILITIES AND PROPRIETORSHIP	
Cash and Due from Banks	$1,152,999.72	Capital Stock	$ 50,000.00
U. S. Government Obligations	1,979,800.00	Surplus	150,000.00
Municipal Securities	35,200.00	Undivided Profits	105,481.04
Corporate Securities	191,744.22	Reserve for Taxes	4,000.00
Federal Reserve Bank Stock	6,000.00	Other Liabilities	6,948.53
Banking House	31,500.00	Postal Savings	3,000.00
Furniture and Fixtures	4,500.00	Bank Checks Outstanding	16,468.96
Loans and Discounts	772,763.87	Deposits	3,838,609.28
	$4,174,507.81		$4,174,507.81

A Bank Statement

Explanation of terms used in this statement—

Cash and Due from Banks: Money in the bank's vaults and money owed to it by other banks.

U. S. Government Obligations: U. S. bonds and notes held by the bank.

Municipal Securities: City or state bonds owned by the bank.

Corporate Securities: Corporation bonds held by the bank.

Federal Reserve Bank Stock: Stock of the Federal reserve bank in Cleveland, Ohio, that the bank owns.

Banking House: The estimated value of the bank building, which is owned by the bank.

Furniture and Fixtures: Estimated value of the vault and other equipment.

Loans and Discounts: Total amount of notes owed to the bank, mostly by local businessmen.

Capital Stock: Par value of the issued capital stock of the bank.

Surplus: Part of the bank's permanent capital.

Undivided Profits: Profits not paid out to stockholders.

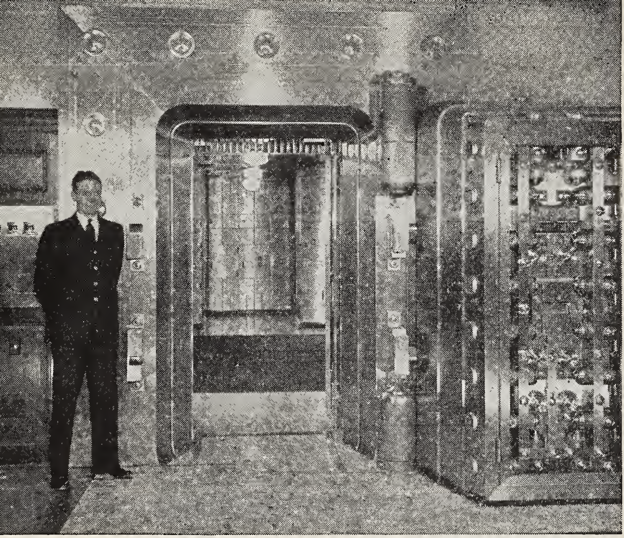
Reserve for Taxes: Profits retained for the purpose of paying taxes.

Other Liabilities: Various kinds of small debts that have not been paid.

Postal Savings: Funds belonging to the post office, which were received from postal savings depositors.

Bank Checks Outstanding: Checks issued by the bank which have not been presented for payment.

Deposits: Includes both time and demand deposits.



Chase National Bank

Entrance to a Bank Vault

The money in a bank is protected from theft by guards and steel vaults.

it will see that the cash on hand does not fall below that amount. On the other hand, it will not want to keep on hand much more than that amount, because cash in the vault does not earn an income. Many banks find that cash to the amount of $1\frac{1}{2}$ per cent of the total time and demand deposits is sufficient. In addition banks keep deposits in certain other banks, called *correspondent banks*. If needed, these deposits may be called for and used to pay depositors' checks.

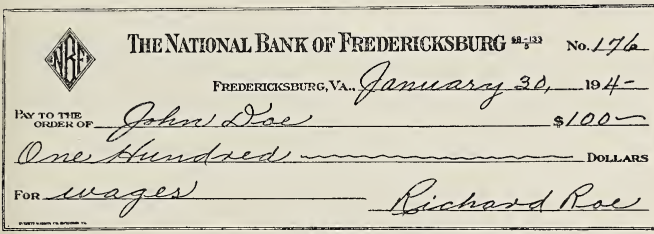
Each national bank is required to keep on deposit with the Federal reserve bank of which it is a member a *lawful reserve* equal to a certain percentage of its deposits. The reserve against deposits varies according to the size of the city in which the national bank is located. The lawful reserves required for banks located in large cities are larger than those required for banks in small cities.

Banking Involves the Use of Credit Instruments. A *credit instrument* is a written or printed instrument that is used in creating or in transferring credit. Among the more commonly used credit instruments are those drawn on banks and used as a substitute for cash, promissory notes, and commercial drafts of several kinds.

Credit Instruments Drawn on Banks. Several kinds of credit instruments are drawn on banks by individuals, busi-

nesses, or other banks for use as a substitute for cash in settlement of business transactions. Those commonly used are checks, bank drafts, cashier's checks, and certified checks.

A *check* is a written order by one who has funds in a bank, called a *depositor*, directing the bank to pay a certain amount of his funds to the person named in the check or to his order.


NBF
THE NATIONAL BANK OF FREDERICKSBURG No. 176
FREDERICKSBURG, VA., January 30, 194-
PAY TO THE ORDER OF John Doe $100—
One Hundred DOLLARS
FOR wages Richard Roe

A Check

A *bank draft* is an order by one bank on another directing the latter to pay a certain sum of money to the order of the person named in the draft. All banks keep deposits in some other banks against which they can draw drafts. Since banks are better known to the public than most individuals, bank drafts are more readily acceptable than personal checks. By the payment of a small fee, bank drafts may be purchased from any commercial bank.

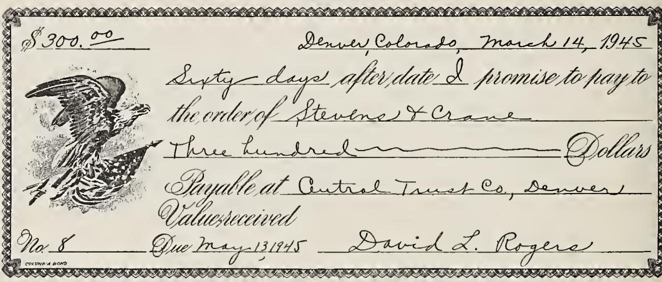
Keystone View Co

Writing Checks to Pay Accounts

Business pays most of its accounts payable by check.

A *cashier's check* is one drawn by a bank on its own funds in the bank. Cashier's checks are used by banks in paying their own debts. A *certified check* is a depositors' check on which the cashier of the bank writes or stamps the word "certified" and signs his name. The amount of the check is deducted from the depositor's account and the bank assumes the obligation of paying the check.

Promissory Notes. A *promissory note* is a written promise to pay a certain sum of money on or by a definite date. In many cases where the buyer does not pay for goods at the time of purchase, he is required to give the seller a promissory note. Then there is less likelihood that a dispute will arise as to the amount of the debt. Also, when one borrows funds from a bank, he gives a written promise that the amount will be paid.


$300.00 Denver, Colorado, March 14, 1945
Sixty days after date I promise to pay to the order of Stevens & Crane
Three hundred Dollars
Payable at Central Trust Co., Denver
Value received
No. 8 Due May 13 1945 David L. Rogers

A Promissory Note

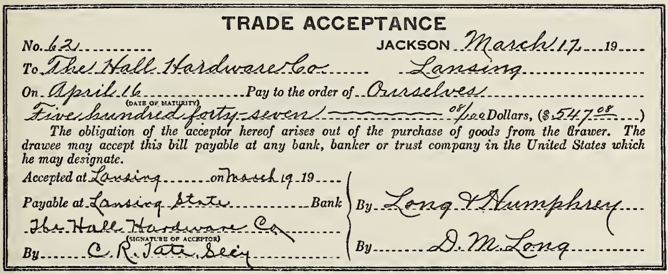
Commercial Drafts. A *commercial draft* is a written order by one person or business concern directing another to pay a certain sum of money to the person or concern named in the draft, or to his "order." If the draft is payable to the order of the person named, it is easy to transfer the draft to another by means of an *endorsement;* that is, by writing one's name on the back of the draft. Promissory notes and checks also may be transferred in this way.

A commercial draft drawn by a person or a business concern in one state or country on another person or concern in another state or country is sometimes referred to as a *foreign*

bill. One drawn on another person or business concern in the same state may be referred to as a *domestic* or *inland bill.*

The person on whom a commercial draft is drawn does not have to pay it until he accepts it. If he is willing to pay the draft, he writes the word "Accepted," together with his name and the date, on the face of the instrument.

A time draft drawn by the seller of goods and accepted by the purchaser is termed a *trade acceptance.* Trade acceptances contain the following statement or its equivalent: "The transaction that gives rise to this instrument is the purchase of goods by the *acceptor* (the person on whom the draft is drawn) from the *drawer* (the person who draws the draft)."



TRADE ACCEPTANCE

No. 62 JACKSON March 17 19

To The Hall Hardware Co. Lansing

On April 16 (DATE OF MATURITY) Pay to the order of Ourselves

Five hundred forty-seven 08/100 Dollars, ($547.08)

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.

Accepted at Lansing on March 19 19

Payable at Lansing State Bank

The Hall Hardware Co. (SIGNATURE OF ACCEPTOR)

By C. R. Tate, Secy

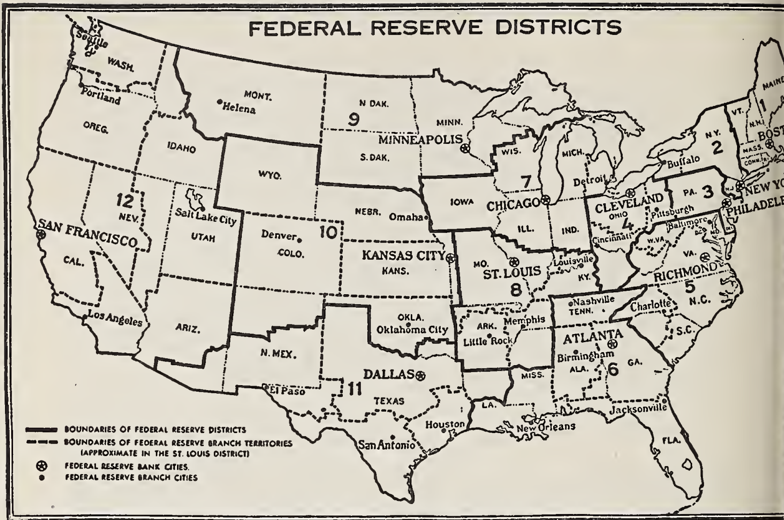
By Long & Humphrey

By D. M. Long

A Trade Acceptance

The Federal Reserve System Aids Commercial Banks. Until 1913 there was little co-ordination and co-operation between the national banks. State banks were subject only to the control of the states in which they were located. This lack of co-ordination had its undesirable features and led to local and national evils. Each bank was virtually a law unto itself as far as co-operation with other banks and communities was concerned. In order to overcome some of the difficulties that existed and to achieve more co-operation and co-ordination among banks, especially among the national banks, the Federal Reserve Act was passed in 1913.

Organization. Under this Act the United States was divided into twelve districts, a Federal reserve bank being located in



A Map of the Federal Reserve Districts
In which Federal reserve district do you live?

each. The numbers of the Federal reserve districts and the cities in which Federal reserve banks are located are as follows: 1, Boston; 2, New York; 3, Philadelphia; 4, Cleveland; 5, Richmond; 6, Atlanta; 7, Chicago; 8, St. Louis; 9, Minneapolis; 10, Kansas City; 11, Dallas; and 12, San Francisco.

It was believed that each region that makes up a Federal reserve district has special banking needs because of its peculiar economic activities. Thus the general banking needs of an agricultural region, like that surrounding St. Louis, for instance, are different in some respects from those of a business community like that of New York.

All the national banks in each district are required by law to become members of the Federal reserve bank in the district. State banks may also become members by meeting the requirements imposed on the national banks with respect to such matters as (1) inspection by Federal bank examiners, (2) reserve requirements, and (3) subscriptions to the capital stock of the Federal reserve bank of the district.

Each member bank must subscribe for stock in the Federal reserve bank to the extent of 6 per cent of its own capital

stock. The stock of each Federal reserve bank is therefore owned by the member banks in the district.

Management. The Federal Reserve System is under the management of the Board of Governors, consisting of seven members appointed by the President and confirmed by the Senate. The Board is kept informed of the financial conditions n the various banking districts by the Federal Advisory Council, composed of one member from each Federal reserve district.

Each Federal reserve bank is under the direction of a board of directors made up of nine members, three of whom are appointed by the Board of Governors and six of whom are elected by the member banks of that district.

Functions. The main functions of the Federal Reserve System are as follows:

1. To hold reserves for member banks.
2. To issue Federal reserve currency.
3. To control the amount of bank credit.
4. To act as a clearinghouse for member banks.
5. To act as a fiscal agent for the Federal Government.

(1) *Holding of Reserves for Member Banks.* We have seen that banks must keep a reserve of money with which to pay out the checks drawn by depositors. No bank would, of course, ordinarily run short of the amount of money needed. But, as a protection to depositors, the state governments, and the Federal Government in the case of national banks, prescribe certain minimum limits for the reserves that banks must keep available.

The Federal Reserve System was created partly for the purpose of providing a safe means of keeping the reserves prescribed by the Federal Government for member banks. Each member bank must keep a specified amount on deposit with the Federal reserve bank to which it belongs. In addition to these reserve deposits specified by law, banks usually keep other kinds of deposits in the Federal reserve banks. Then, if the need arises, the bank can call upon the Federal reserve bank for the amount of the money required to meet the demand of its depositors.

(2) *Issuing of Federal Reserve Currency.* When business is active, a greater amount of money or of bank credit is needed than when business is dull. If there is not sufficient money or credit, business is handicapped and prices fall. On the other hand, when business activity begins to decrease, less money and credit are needed. The amount of money and credit available for use should therefore decrease as the amount of buying and selling slows down. If the amount of money and credit remains the same as it was when business was good, prices will be too high. There will be more money and credit than are needed, and both will therefore have less value. In other words, it is said that the volume of money and credit should be elastic; it should expand when the amount of business increases and should contract when business activity decreases.

Prior to the creation of the Federal Reserve System, the amount of money in circulation in the country remained about the same, regardless of the condition of business. It was inelastic. The volume of money in use depended upon the amount of greenbacks, the amount of bank notes issued by national banks, and the amount of gold and silver held by the Government.

Merchants and other businessmen who hold notes and trade acceptances that they have received from the sale of goods can take these credit instruments to the bank and borrow on them, that is, sell them to the bank. If the bank then needs additional funds, it can send these notes and trade acceptances to the Federal reserve bank in the district and can rediscount (or sell) them. Or it may give its own promissory note to the Federal reserve bank and pledge its customers' notes and other commercial paper that the note will be paid.

In either case, the Federal reserve bank will give the bank Federal reserve notes or credit the bank's account. If the bank takes the Federal reserve notes, it in turn pays them out to its customers.

When the notes and trade acceptances are paid by those who signed or accepted them, there is a decrease in the amount of money in the hands of individuals. Thus the Federal Reserve System makes an elastic currency system possible, which tends to prevent the extreme fluctuations in prices that would

take place without such elasticity. The amount of money and credit tends to correspond to the needs of business.

(3) *The Control of the Amount of Bank Credit.* There are several ways by which Federal reserve banks may attempt to control the volume of bank credit in the United States. One of these methods is by changing the discount or interest rate that the Federal reserve banks charge member banks for loans. By raising the discount rate, member banks may be discouraged from borrowing at the Federal reserve banks. When this happens, the amount of loans that member banks may make to business concerns becomes more limited.

On the other hand, by lowering the discount rate, the Federal reserve banks may encourage member banks to borrow. As borrowing by member banks becomes easier, the amount of the loans that may be made to business concerns by member banks increases.

Another method of controlling the volume of credit that is used by the Federal Reserve System is that of open-market operations. This term is rather technical. Generally speaking, however, we may say that *open-market operations* refer to the buying and selling of bonds and certain kinds of commercial credit instruments. When the Federal reserve banks buy bonds and commercial paper, more money and credit that can be used by business concerns are put into circulation.

Commercial banks keep part of their funds invested in bonds and other kinds of credit instruments. If the Federal reserve bank in your district should buy $100,000 worth of bonds from the First National Bank, that would give the commercial bank an additional amount of money that could be used as a reserve for loans to businessmen in the community. Thus the amount of bank credit would be expanded.

But when the Federal reserve banks sell bonds and commercial paper, less money and credit are available for use by businessmen. For example, if the Federal reserve bank sells $100,000 worth of bonds to the First National Bank, the commercial bank will have to use its money or credit to buy the bonds. It will therefore have a smaller reserve on which loans can be made to local business concerns.

(4) *Clearinghouse for Member Banks.* The Federal Reserve System greatly simplifies the method by which checks that have been deposited in banks or paid by banks are transferred to the banks on which they are drawn. For example, Jones, who lives in the city of Fredericksburg, Virginia, 50 miles north of Richmond, and in the fifth reserve district, sends his check to Smith, who lives in Chicago. Smith deposits the check in his Chicago bank, the First National Bank. The First National Bank sends the check to the Federal reserve bank in Chicago, which in turn sends it to the Federal reserve bank in Richmond. The latter bank then sends the check to Jones's bank in Fredericksburg, where the amount of the check is deducted from Jones's account. Thus the collection of checks deposited in thousands of banks all over the country is facilitated. The sending of checks from one bank to another and the collecting of an amount owed by one bank to another is called *clearing.*

(5) *Fiscal Agent for the United States Government.* In some years the Federal Government collects billions of dollars in taxes and from loans. All this money is paid out for the maintenance of the Army and the Navy, for the improvement of harbors and navigable streams, for pensions, for the aid of industry, and for other activities that are considered to be of benefit to the general public. So great, therefore, are its financial activities that the Government must have some fiscal, or financial, agent to hold and pay out its money. These services are performed by the Federal Reserve System.

The F. D. I. C. Insures Deposits. Until a few years ago, when a bank failed, the depositors usually lost a part or all of their deposits. But under laws passed by Congress in 1933 and 1935 a plan was provided for the insurance of deposits. Deposits may now be insured to a maximum of $5,000. Under the plan all national banks and state banks that are members of the Federal Reserve System are required to insure their deposits with the Federal Deposit Insurance Corporation. The Corporation is a private concern. The Government owns $150,000,000 of the capital stock; the rest of the capital is supplied by banks.

Each insured bank annually is assessed an amount equal to $\frac{1}{12}$ of 1 per cent of its average deposits for a period of the pre-

ceding six months. The amount is paid to the Federal Deposit Insurance Corporation. In this way a fund is built up to be used to pay depositors if an insured bank should fail.

Only deposits of $5,000 or less are insured. Deposits of more than this amount are not covered. For example, if you had $10,000 on deposit in the First National Bank, only half of the amount would be insured. The fact that the smaller depositors are insured does not, therefore, remove the need for good management on the part of the banks. Since banks are eager to have the business of large depositors, they still find it important to conduct their affairs so as to merit the confidence of the large business concerns.

Banks Are Vitally Important. The services that banks perform are so essential in their nature and so far-reaching in their effects that it is difficult to overemphasize the importance of good banking practices. By permitting loans to certain concerns and individuals, banks may encourage particular kinds of businesses; or, by denying loans to others, they may discourage other business undertakings.

By raising or lowering the discount rates on loans, individual banks, and particularly the Federal reserve banks, can discourage or encourage borrowing by businessmen. When the interest rate is high, a businessman is not likely to borrow so much or so readily as he would if the interest rate were lower. Banks may discourage speculative borrowing by raising interest rates, or may encourage business ventures by lowering the rates.

Banks also tend to stimulate saving by providing a comparatively safe place for deposits. And, as we have seen, they manufacture credit, which is used as a medium of exchange in carrying on business transactions. The credit thus created is far greater in amount than the value of all the precious metals. Without bank credit, business could not be carried on as it is.

QUESTIONS ON THE CHAPTER

1. Upon what is credit based?
2. What is the difference between commercial credit and investment credit?

3. What are the advantages and disadvantages of charge accounts? Do you feel that the advantages outweigh the disadvantages or that the disadvantages outweigh the advantages?
4. How does an installment purchase differ from a purchase on a charge account?
5. Why is a carrying charge of 6 per cent approximately equal to an interest rate of 12 per cent?
6. What are the advantages and disadvantages of installment buying? Do you feel that the advantages outweigh the disadvantages or that the disadvantages outweigh the advantages?
7. How does credit serve the same purpose as money?
8. Why do we say a man frequently borrows credit rather than money?
9. Where do banks get the credit they lend to others?
10. How does a demand deposit differ from a time deposit?
11. Why are bank loans usually made for short periods of time? Is it possible to have a note renewed?
12. About what percentage of the total deposits is needed as a working reserve?
13. How does a check differ from a bank draft?
14. What was the purpose in creating the Federal Reserve System?
15. How is the Federal Reserve System organized?
16. What are the main functions of the Federal Reserve System?
17. How does the Federal Reserve System serve as a fiscal agent for the United States Government?
18. Distinguish between "state" banks and "national" banks.
19. Why do people feel that banks are a safe place for savings?
20. What is the meaning of each of the following terms?

(a) **acceptor**
(b) **agricultural credit**
(c) **bank draft**
(d) **carrying charge**
(e) **cashier's check**
(f) **certified check**
(g) **charge account**
(h) **check**
(i) **clearing**
(j) **commercial bank**
(k) **commercial credit**
(l) **commercial draft**
(m) **correspondent bank**
(n) **credit**
(o) **credit instrument**
(p) **demand deposit**
(q) **depositor**
(r) **deposits**
(s) **drawer**
(t) **endorsement**
(u) **Federal Reserve System**
(v) **foreign bill**
(w) **inland bill**
(x) **installment credit**
(y) **investment credit**
(z) **lawful reserve**
(aa) **national bank**
(bb) **open market operations**
(cc) **personal credit**
(dd) **promissory note**
(ee) **state bank**
(ff) **time deposit**
(gg) **trade acceptance**
(hh) **working reserve**

APPLICATIONS OF THE CHAPTER

1. Report on a current newspaper or magazine article dealing with the subject of commercial banking.
2. Discuss the evolution of credit. Consider (a) barter, (b) commodity money, (c) paper money, and (d) credit.
3. By the use of an illustration explain how it is possible for a bank to agree to pay out more money than it has on hand. Why does it usually not fail in such a case?
4. What are the qualifications of a successful banker? Consider (a) the necessity for keeping the bank "liquid," that is, keeping it in a position to meet all demands for checks drawn on it; (b) the desirability of earning profits for the stockholders; (c) the influence that credit has on the encouragement and the discouragement of different kinds of industry.
5. It has been said that all banks should be chartered by the National Government. What are the arguments that you can give for and against the proposal?
6. A wholesaler receives a trade acceptance from a retailer as the latter's promise to pay for goods within sixty days. Explain (a) how, under the Federal Reserve System, the wholesaler can obtain money or credit for the acceptance; (b) where the bank will get the money or the credit to lend to the wholesaler; (c) what security will be behind the money that the member bank obtains from the Federal reserve bank; (d) how the loan will result in increasing the amount of money in circulation; and (e) how, when the wholesaler repays his loan, the amount of money in circulation will contract.
7. At intervals banks publish statements showing their financial condition. Procure a bank statement, and tell what each of the items on the statement means.
8. Compare credit and money as media of exchange. Consider (a) the nature of each; (b) the element of confidence; (c) the origin of each; (d) what gives each acceptability; (e) the extent of the acceptability of each; (f) the convenience of each; and (g) the times when each is used.
9. It has been said that banks manufacture credit. From the point of view of the commercial bank, how does personal credit resemble raw materials used in manufacturing?
10. Do you believe that the control of the Federal Reserve System should be in the hands of a board, the members of which could not be removed except for crime or extreme negligence of duty? Why?
11. (a) Explain fully how a businessman borrows from a bank. (b) Why is a bank very careful to see that all loans are paid on the due dates? Why is a businessman eager to pay his loan on the date on which it is due?

12. Are runs on banks as likely to develop since deposits are insured up to $5,000? How does the insurance of deposits protect depositors? How does it protect banks? Suggest reasons why some banks may look upon the guarantee of bank deposits with disfavor?

TOPICS FOR SPECIAL REPORTS

1. The First Bank and the Second Bank of the United States.
2. The independent treasury system.
3. The national banking system.
4. The reasons for the passage of the Federal Reserve Bank Act in 1913.
5. The Federal Reserve System.
6. Banking laws under the administration of Franklin D. Roosevelt.
7. The Securities Act of 1933.
8. Installment buying.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should commercial banks be forbidden by law to lend credit on corporate stocks.
2. Is the insurance of bank deposits an unnecessary expense to banks?
3. Can bankers prevent unsound business development or booms?
4. Does the Government exercise too much control over banks?
5. Should the Government discourage installment buying through restrictive legislation?

CHAPTER 18

SAVINGS AND INVESTMENT INSTITUTIONS

A spendthrift's greatest delight is in spending money. A miser's chief pleasure is in saving and hoarding money. The former may have fun as long as his money lasts, and the latter may grow rich. But both are equally foolish and lacking in an understanding of the proper use of money.

A thrifty person, on the other hand, realizes that life in the present is important—but not all-important. He does not deny himself those things that are necessary to his present welfare. But neither does he spend his money recklessly and without regard to his probable needs in the future. For he expects to live in the future, and he knows that he will have wants which money can be used to satisfy.

After one has earned an income, one of his most difficult problems is to keep from spending all he has. If he succeeds in setting aside a part of his income for future use, he must then decide what to do with it. Before reaching a decision, he should ask himself the following questions: Will the money be safe? Will it earn a fair rate of interest or dividends? Shall I be able to get back the amount within a reasonable time if I should unexpectedly need it? For a person of moderate means the answer to each of these questions should be "yes."

There Are Many Kinds of Specialized Savings Institutions. There are a number of different kinds of institutions that stand ready to help you save systematically. The most important of these are: (1) commercial banks; (2) savings banks; (3) the postal savings system; (4) building and loan associations, sometimes called co-operative banks; (5) the United States Treasury, by providing savings bonds and stamps; (6) insurance companies; and (7) credit unions, which were discussed in Chapter 9.

Commercial Banks. Commercial banks may accept time or savings deposits, on which they pay a low rate of interest. In the past most commercial banks did not give a great deal of attention to savings deposits. Recently, however, there is a tendency for commercial banks to enter the savings field by establishing "savings departments."

Savings Banks. There are some banks the main functions of which are to accept deposits and to lend the deposits on long-time terms to reliable borrowers at a higher rate of interest than the banks pay depositors. Such institutions are called *savings banks.* Savings banks are intended to provide a safe place for the savings of wage earners and others whose savings are not large. The amount of deposits on which interest will be paid is limited.

When money is deposited in a savings bank, the bank has a right to demand notice, perhaps of thirty days, before allowing the money to be withdrawn. You will remember that commercial banks also have this right concerning time deposits. The reason for this rule is that the bank lends to responsible persons or businesses the deposits that it receives and thus may require time to accumulate enough cash with which to pay a depositor. If the amount is not large, the depositor may, however, usually withdraw part or all of the money at any time. Checks may not be written against deposits in savings banks.

Stock Savings Banks. The stock savings bank is a corporation that is organized under the laws of the state. It is organ-

Ewing Galloway

Making Deposits in a Savings Bank

The deposits in savings banks supply funds for long-term loans to business enterprises and governmental units.

ized and conducted for profit. It pays its depositors a specified rate of interest and makes whatever profit it can by putting the deposits of the bank into conservative investments.

The bank is under the regulation of the state in which it has been chartered. In order to help protect depositors by discouraging the managers of the bank from taking too much risk in making investments, the state usually issues a list of the kinds of borrowers to whom the funds of the bank may be lent. Certain types of bonds and other possible investments are thus designated as being suitable for the investment of savings-bank funds. A part of the profits is usually retained as reserves in the bank and the remainder is paid to the stockholders.

The greater number of stock savings banks are located in the middle western states.

Mutual Savings Banks. In the case of a mutual savings bank the depositors are the owners of the bank. In effect they simply pool their savings, which are invested by a board of trustees and a hired manager. Depositors are paid a fixed rate of interest on their deposits. Whatever additional earnings are made from the investments belong to the depositors and are divided among them in proportion to the amount and the time of their deposits. As in the case of stock savings banks, the investments of mutual savings banks are usually regulated by state laws. There are a considerable number of mutual savings banks in the New England and the Middle Atlantic states.

The Personal and Social Service of Savings Banks. Savings banks of all kinds afford comparatively safe places in which to keep savings, and at the same time they enable persons to realize a small income from their savings. Moreover, savings banks perform a valuable service to society in general by collecting thousands of small amounts, the total of which is large, and by making the accumulated savings thus collected available as loans for the use of business enterprises of many kinds, as well as for the use of city, state, and National governments. The total amount of savings deposits in all kinds of savings accounts in the United States amounts to many billions of dollars. The total of all deposits in savings banks probably exceeds the value of the railroad property in the United States.

The Postal Savings System. The Postal Savings System is operated by the Post Office Department. It was established in 1911 to provide facilities for saving to those to whom banks were not convenient. A low rate of interest is paid on deposits. A deposit of $1 will open an account at a post office. Deposits of any number of dollars will be accepted until the balance of the account reaches $2,500.

If one does not have the dollar necessary to begin a postal savings account, he can purchase postal savings stamps for 10 cents each. When he has purchased ten stamps, the stamps may be used to make a postal savings deposit of $1.

When a postal savings deposit is made, the depositor is given a postal savings certificate. The depositor may withdraw his savings, or any part of them, by presenting his certificates at the post office for payment.

Five per cent of postal savings received by post offices must be deposited with the Treasurer of the United States. The remainder may be deposited in approved banks or invested in bonds of the United States. During recent years the greater part of postal savings funds have been invested in the bonds of the Government.

Building and Loan Associations. The objects of this type of financial organization are (1) to aid persons to become home-owners and (2) to encourage thrift. The names by which these associations are known vary in different parts of the country. They may be referred to as "building and loan associations," "savings and loan associations," or "co-operative banks." Their origin may be traced back to the British building associations in the latter part of the eighteenth century. The first instance of this type of organization in the United States was that which was founded in Philadelphia in 1831.

There is considerable variation in the ways in which building and loan associations are organized and operate. Some are organized under state charters and others, under Federal charters. In general, however, the associations provide opportunities for systematic savings and for borrowing for the purpose of acquiring a home. Money deposited with building and loan associations may not be withdrawn by check.

Building and loan associations are co-operative institutions; that is, they are owned by the members, who are entitled to receive any interest or profit that is earned on their deposits. Funds are received by the association from members who buy shares, and loans are made on real estate.

Shares. The associations issue different kinds of shares. The kinds most frequently issued are installment, full-paid, and prepaid shares.

Installment shares may be purchased and paid for by means of regular installments, or dues, which usually amount to 50 cents or $1 a week for each share. Compound interest is allowed on the installments that have been paid, so that the purchaser of a share does not have to pay the full amount of the face value of the share. Interest rates and the time of payment varies. But the principle followed may be illustrated by an example. Suppose the association allows 3 per cent interest, which is compounded semiannually, and that you wish to buy a $100 share and pay for it by making a payment of $1 monthly. At the end of 84 months, you will have paid in $84, and the interest that the association will allow you will amount to $16. Thus, the total of the installments and the accumulated interest will equal $100, the face of the share. At that time you will be allowed to withdraw the amount, $100, or you will probably be permitted to exchange it for a full-paid share. If you accept a *full-paid share,* you will receive dividends on the face value, which will be paid quarterly or semiannually. Full-paid shares may also be purchased by paying a lump sum equal to the face value of the share.

Prepaid shares are sold at less than face value. For example, it may be possible to purchase a $100 share by paying $75. The amount paid will begin drawing interest, and at the end of a number of years, say ten, the total of the original payment plus the accumulated interest will equal $100, the face value of the share. At this time the share would be worth $100.

Loans. Loans are made by building and loan associations on real-estate mortgages. In some cases the amount of the loan may amount to as much as 80 per cent of the value of the

property. The person wishing to obtain money for building or purchasing a home gives a mortgage on the property, obtains the money at once, and agrees to repay the amount in regular installments. He is required to pay to the association a certain amount each month, a part of which is used to pay the interest on the debt remaining unpaid and the remainder, to reduce the amount of the principal. The time of payment may run from five to twenty years, depending upon the amount of the monthly payment as determined by the agreement that the borrower makes with the association.

Savings accounts in building and loan associations are usually insured up to a maximum of $5,000 a person. This insurance is provided by a special Federal savings and loan insurance plan, similar to the arrangement for insuring bank deposits. Associations may operate under either a state or a Federal charter. Those that are chartered by the Federal Government must insure the accounts of their members. Insurance under the plan is optional with associations that do not operate under Federal charters.

United States Savings Stamps and Bonds. In spite of the fact that individuals and business concerns pay taxes totaling many billions of dollars each year, the Federal Treasury has to borrow a great deal in order to meet its obligations. At one time, it was the practice of the Treasury to borrow the funds it needed from banks and big business corporations. The bonds, or long-time notes on which the funds were borrowed, were in denominations of $1,000 and more. In 1935, the Treasury began the practice of selling bonds of small denominations to individuals.

The Cost of Savings Bonds. The maturity values of these bonds range from $25 to $1,000. The bonds are sold at a discount from the maturity or face value. For example, a bond with a maturity value of $25, at the end of ten years, costs $18.75. Thus, if the buyer of a bond of this denomination holds it for ten years, he will receive $6.25 more than he paid for it. This amount is equal to interest on the investment of 2.9 per cent compounded semiannually.

The table below gives the cost or issue price and the maturity value of the different denominations of United States savings bonds.

COST OR ISSUE PRICE	MATURITY OR FACE VALUE
$ 18.75	$ 25.00
37.50	50.00
75.00	100.00
375.00	500.00
750.00	1,000.00

In order to encourage persons whose incomes are not large to practice systematic saving, the Government makes it possible for one to purchase savings stamps. The stamps are in small denominations. When enough have been accumulated, they may be exchanged for a savings bond.

The savings bonds and stamps of the Government may be purchased at banks, post offices, and other places authorized to sell them.

The Cash Value of Savings Bonds. In case of emergency the holder of a savings bond may wish to sell it before its date of maturity. In order to encourage the sale of the bonds, the Treasury has agreed to redeem them at any time after sixty days from the date of purchase. If a bond is redeemed within a year after purchase, the owner receives only the amount he paid for it. If he redeems it after he has held it a year and a half, he will receive slightly more than he paid for it. And the longer he holds it, the more he will receive, until, at the end of ten years, he will receive the full face value. Savings bonds may be redeemed at any bank designated by the Federal Government.

Insurance Companies. Insurance covers many fields of risk. The kinds of insurance with which everyone is familiar include accident, health, life, and property insurance of various kinds, including protection against loss from fire, tornado, theft, collision, and so forth.

The principle underlying insurance is the sharing of risks. To begin with, statistics are collected to permit the making of an intelligent estimate as to the likelihood that a certain type

of event will happen in a given number of cases. For example, it is found that, on the average, a certain number of residences in a hundred thousand will be destroyed by fire during a certain period of time. A particular individual does not know whether his house will be one that will be burned. In order to protect himself against loss in the event that it is destroyed by fire, however, he is usually willing to pay into a fund an annual amount, called a *premium*. From this fund he will be indemnified in case his house burns.

Life insurance is protection against economic loss to one's dependents or to his estate as a result of death. Some kinds of life insurance also make it easy for one to build up an estate that he can use later in life. For these reasons life insurance may be regarded as a form of saving or investment.

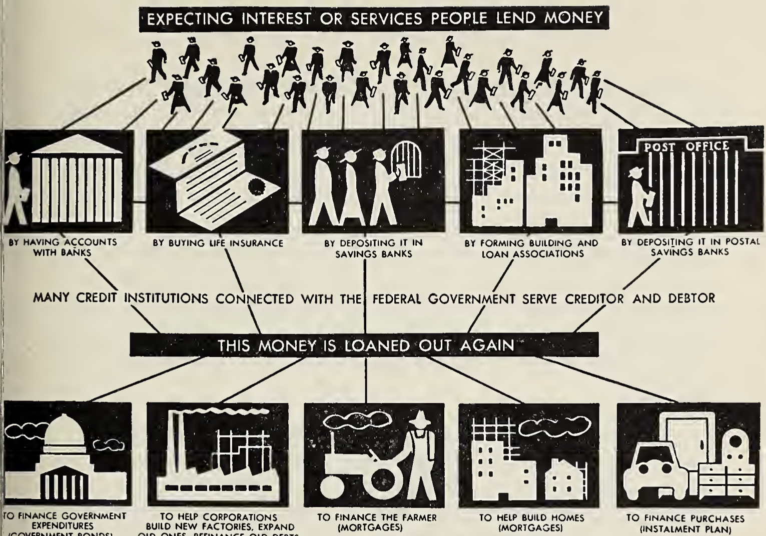
There are many kinds of life insurance policies. One of the most common is known as a *straight-life policy*, for which premiums must be paid as long as the policyholder lives. This kind of life insurance is less expensive than most other forms of policies.

Two other plans of life insurance are the limited-payment plan and the endowment plan. Under the *limited-payment plan* the insured person pays his regular premiums for a certain number of years, probably fifteen or twenty. At the expiration of the stated period of time, the payment of premiums is discontinued. Upon the death of the insured person, the company pays to his beneficiary the amount of the insurance policy. If the insured dies, however, before he has paid all the premiums, the amount of the policy will be paid to his beneficiary. Under the *endowment plan* the insured person pays a stated premium for a given number of years. At the end of that time he receives the amount of the policy. If he should die before he collected the policy, the amount would be paid to his beneficiary.

There are a great many kinds of life insurance policies, but most of them are variations of those indicated above.

The primary functions of insurance companies are (1) to afford protection against various kinds of risks and (2) to collect, in the form of premiums, funds that are lent to reliable businesses and governments.

HE FUNCTION OF DEBTS



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There Are Various Kinds of Investment Institutions. There are a number of institutions that are designed to supply credit for long-term purposes and to perform other services that are not ordinarily undertaken by the kinds of financial institutions that we have discussed in this and the preceding chapter. Among these institutions are (1) investment banks, (2) the Federal Home Loan Bank Administration, (3) the Federal Housing Administration, (4) the Farm Credit Administration, (5) the Reconstruction Finance Corporation, (6) the Commodity Credit Corporation, (7) trust companies, and (8) stock exchanges.

Investment Banks. Cities, counties, states, the United States Government, foreign governments, and large business corporations need a great amount of funds each year. In order to obtain these huge amounts of money, bonds and stocks are sold to many millions of persons and business concerns.

If the bonds and the stocks had to be sold by sending out agents of the companies, it would take too long a time to dispose of the securities. To facilitate the sale of such securities,

therefore, certain individuals and firms undertake to supply the money needed and to arrange for the sale of the bonds and the stocks. Persons engaged in this type of business are called *investment bankers.* The investment bankers usually receive as their compensation a certain percentage of the value of the securities that they undertake to sell. Sometimes, in the case of a corporation that requires an exceptionally large sum of money, a number of investment bankers will jointly take over the sale of the bonds or the stock, thus forming what is known as a *syndicate.* Each member of the syndicate will then sell the part of the bonds or the stocks for which he agreed to be responsible.

The Operations of Investment Banking. In principle the operation of investment banking is simple. A business corporation that desires to obtain money turns over its bonds or its stock to the investment banker. If the banker does not have the money or the credit needed by the business corporation, he borrows it and pledges the securities for the loan. Thus the business concern obtains funds without having to wait until the securities have been sold to the thousands of investors who may eventually buy them.

As the investment banker has connections with other investment bankers, commercial banks, savings banks, and other financial organizations, he may send them some of the securities that he holds. These organizations will, in turn, attempt to dispose of the bonds or the stocks to their clients, or possibly they themselves will buy some of them as temporary investments.

The Services of Investment Banks. Investment banks, therefore, perform two distinct services: (1) They assist governments and corporations in obtaining quickly the funds they need. (2) They make high-grade securities available to investors, large and small, all over the country. An individual who wishes to save part of his income may find it to his advantage to buy from his bank a bond or a stock that has been purchased from an investment banker.

Investment bankers have a splendid opportunity to discourage the issuance of watered stocks and worthless bonds. They are in a position to know about such matters and to refuse

to offer poor stocks and bonds to the public. Unfortunately, however, some investment bankers have been guilty of incompetence and downright dishonesty. In some instances they have sold worthless securities to the people who trusted them. It must not be thought, however, that all, or even a majority, of the investment bankers are dishonest.

Nearly all securities issued by corporations must be registered with the Securities Exchange Commission. In order to register the securities, the corporation must give the Commission complete information concerning its financial condition. This is intended to protect investors who buy the stocks and the bonds of the corporation.

Federal Home Loan Bank Administration. The Federal Home Loan Bank System is a central credit reserve system for savings and home-financing institutions, including building and loan associations, as well as insurance companies and savings banks in some cases. Home Loan Banks supply long-term credit to building and loan companies and certain other types of concerns that have to do with financing the construction of homes.

The Federal Savings and Loan Insurance Corporation was created to insure the safety of deposits, up to $5,000, in Federal savings and loan associations and in state-chartered institutions of the building-and-loan type.

Federal Housing Administration. The law creating the FHA states that this agency is intended "to encourage improvement in housing standards and conditions, to provide a system of mutual mortgage insurance, and for other purposes."

In the case of homes costing $5,400 or less, the FHA will guarantee loans up to 90 per cent of the value of the home. Thus if one has $500 and wishes to build a home costing $5,000, he probably can obtain a loan of $4,500 from a local bank, with the privilege of paying the loan over a period of twenty-five years, with interest. In the case of more expensive houses, the Administration will guarantee loans to only 80 per cent of the value of the property. Not all banks are willing to make loans under the FHA plan, but those that do are protected against loss because the Federal Government stands back of the loans.

During World War II the services of savings and loan associations and FHA were much restricted. It was almost impossible to secure materials and labor for civilian construction purposes.

Farm Credit Administration. The Farm Credit Administration is made up of a number of separate governmental financial institutions that formerly were independent of each other. These include: twelve Federal land banks, which make long-time loans to farmers, usually for the purchase of land; twelve intermediate credit banks, which make loans of from one to three years, principally for the purchase of livestock and to carry on co-operative marketing activities; twelve production credit associations, which make loans for general agricultural production purposes; one central and twelve regional banks for co-operative marketing and purchasing organizations; and the Federal Farm Mortgage Corporation, which supplies credit to the Federal land banks.

We see, therefore, that the Government supplies farm credit for long-, short-, and intermediate-maturity loans. Most of the credit is intended to aid farmers in making investments in their farms, but some of the credit that is made available to farmers by the Government can be used for general operating purposes.

Reconstruction Finance Corporation. The RFC was originally created by an act of Congress entitled, "An Act to provide emergency financing facilities for financial institutions, to aid in financing agriculture, commerce, and industry, and for other purposes." It was established in 1932. Since that time the original act has been amended several times, and the scope of its activities has greatly expanded. The Corporation can make loans to public agencies, financial institutions, insurance companies, railroads, drainage, levee, irrigation and similar districts, mining and fishing industries, and public school districts; buy stock in banks, insurance companies, and mortgage companies; make loans for nearly all kinds of agricultural purposes; and indulge in a great many other kinds of financial activities. In 1943 the total amount of loans and promises to make loans was nearly twenty-six billions of dollars.

Commodity Credit Corporation. This agency of the Government is primarily a lending institution. It makes loans to co-operative marketing associations. During World War II it encouraged the production of certain crops and made purchases of some commodities that could not be produced in sufficient quantities in this country.

Trust Companies. Trust companies are formed as distinct concerns or as departments of commercial banks. They should not be confused with trusts, which are created for the purpose of monopolizing trade or of fixing prices.

Trust companies act as trustees for the administration of funds and estates, serve as the registrars of stocks and bonds for corporations, and perform certain other functions. A few illustrations will indicate some of the services that trust companies perform.

(1) A man who owns considerable property may specify in his will that the administration of his estate at his death will be left to a trust company. His property may consist of stocks and bonds, insurance money, real estate, and other property. The trust company, having special facilities and experts in financial matters, is well equipped to carry out the wishes of the owner.

(2) A man may wish to set aside a certain sum of money, the income from which will be used for the benefit of some individual. The trust company is prepared to keep the money safely invested and to make regular payment of the income to the beneficiary of the trust.

(3) Recording the transfers of the stocks and the bonds of large corporations from sellers to buyers and the payments of dividends and interest is a task calling for special facilities. This work is usually performed by trust companies and banks.

Trust companies often engage also in commercial banking. Likewise, commercial banks often perform services like those rendered by trust companies.

Stock Exchanges. A stock exchange is not, strictly speaking, a financial institution. It is an organization of individuals that is formed for the purpose of trading in the securities of corporations, which are the basis of many investments. When corpo-

rations play as important a part in the ownership of productive enterprises as they do today, it is necessary that there be some means by which stocks and bonds may be bought and sold readily. The stock exchanges exist to perform this important function. The most important of the security exchanges in the United States are the New York Stock Exchange and the New York Curb Exchange.

The Federal Government exercises control over stock exchanges by means of the Securities and Exchange Commission, which is composed of five members appointed by the President and approved by the Senate. Exchanges must be licensed before beginning operation. Corporations whose securities are listed on a stock exchange must file with the Commission complete statements showing the organization and the financial condition of the concerns. Prospective buyers of stocks and bonds can therefore obtain reliable information concerning the companies in whose securities they may be interested. The Board of Governors of the Federal Reserve System has the power to fix the margins required on securities purchased through stockbrokers.

Margin is the amount of money that the buyer must deposit with the stockbroker when he buys stocks or bonds. Formerly it was possible to deposit a small percentage of the purchase price and to borrow the remainder from the broker. In the event the price of the security he had bought rose, the buyer might sell the security at a profit. But if the price fell, the broker would be compelled to sell the stock unless the buyer deposited more money. In case the broker was compelled to sell the security, the buyer would lose part or all the money that he had invested in the stock or bond.

Under the regulation of the Securities and Exchange Commission (SEC), many of the former undesirable practices of the exchanges have been eliminated or curtailed. Buying and selling securities on stock exchanges for the purpose of speculation, however, should be left to those who can afford risks and who have the ability to estimate the values of securities. The uninformed buyer of stocks and bonds need not be surprised if he loses his savings.

QUESTIONS ON THE CHAPTER

1. How would you distinguish among a spendthrift, a miser, and a thrifty person?
2. In trying to decide what to do with his savings, what questions should one ask himself?
3. Explain how each of the following institutions may be used as aids to saving: commercial bank; savings bank; postal savings system; building and loan association; United States savings stamps and savings bonds; insurance company.
4. May one withdraw his money from a savings bank at any time?
5. Distinguish between mutual and stock savings banks.
6. What is meant by a "share" in a building and loan association?
7. To whom are loans made by building and loan associations?
8. Are accounts in building and loan associations safe? Why?
9. What are the issue prices of United States Savings bonds?
10. Can one obtain cash for a United States Savings bond? If so, how?
11. What services do investment banks render?
12. Does the SEC have any control over investment banking?
13. What is the meaning of each of the following terms?

(a) **building and loan association**
(b) **CCC**
(c) **endowment plan**
(d) **FCA**
(e) **FHA**
(f) **FHLBA**
(g) **full-paid share**
(h) **installment share**
(i) **investment bankers**
(j) **life insurance**
(k) **limited-payment plan**
(l) **margin**
(m) **mutual savings bank**
(n) **Postal Savings System**
(o) **premium**
(p) **prepaid share**
(q) **RFC**
(r) **savings bank**
(s) **stock exchange**
(t) **stock savings bank**
(u) **straight-life policy**
(v) **syndicate**
(w) **trust company**

APPLICATIONS OF THE CHAPTER

1. Report on some article you have read recently that concerns a topic discussed in this chapter.
2. Discuss the types of investment made by savings institutions located in your community.
3. How much money would you have at the end of ten years if you saved $100 a year and lent it out at 4 per cent? How long does a sum require to double itself if lent out at 4 per cent interest and the interest is allowed to accumulate? at 5 per cent? at 6 per cent? (Consult compound-interest tables.)

4. Which would you prefer to buy: a United States Government bond for $1,000 that pays 2 per cent interest, or a $1,000 bond of a manufacturing company that pays 6 per cent interest? Discuss all the factors that you would consider.
5. In what way do investment banks contribute to (a) the building of factories, stores, office buildings, roads, streets, and other types of construction, and (b) the providing of opportunities for saving?
6. Report on the work of the building and loan association in your community. If there is no building and loan company in your community, obtain information concerning the one that is located nearest to you.
7. Report on the work that the Federal Government is doing in helping home owners to build or to repair their homes.
8. Give some examples to show how trust companies operate. (Information may be obtained from a local trust company.)
9. What does an insurance company do with the money that is paid to it in the form of premiums?
10. How does the Federal Government regulate the stock exchanges?
11. Compare the organization and the operation of mutual savings banks and stock savings banks. Which type of savings banks seems to possess the greater advantages for the depositor?
12. Compare the functions of an investment bank and a commercial bank.
13. Should investment banks be regulated by law? Why?
14. Explain why savings banks reserve the right to require several days' notice before paying a depositor.
15. What classes of people patronize each of the kinds of financial institutions discussed in this chapter? Why?

TOPICS FOR SPECIAL REPORTS

1. The Reconstruction Finance Corporation.
2. The social importance of investment banking.
3. The purposes and the operation of a building and loan association.
4. The work of the Federal Government in aiding home owners and home builders.
5. Farmers' banks.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should a commercial bank be prohibited from engaging in investment banking?
2. Should stock exchanges be abolished?
3. Should investment banking be supervised by the Government?

CHAPTER 19

PAYMENTS BETWEEN COUNTRIES

If you should order a woolen coat that cost ten pounds sterling from a London merchant, how could you make payment? As you know, our monetary unit is the dollar and that of the English, the pound sterling. The English merchant would insist upon being paid in pounds. But you have only dollars with which to pay for the coat. Obviously you would have to exchange your dollars for pounds. This you could do by going to a bank and arranging to buy a ten-pound draft. How can the bank sell you pounds? What will a pound of English money cost?

These questions may make it appear that the subject of making payments abroad is difficult to understand. But, as we shall see, the principles that underlie foreign payments are few and rather easy to understand.

What Are Exports and Imports? The general term *exports* refers to goods and services sold to other countries. The term *imports* refers to goods and services purchased from abroad by people in this country. When we speak of the exports or the imports of a nation, we should realize that most of the selling and the buying referred to is done by individuals and not by governments.

Visible and Invisible Exports and Imports. Commodities, like silk, machinery, clothing, and cutlery, are called *visible exports* or *imports,* depending upon whether they are sold or bought.

Anything other than merchandise sold to anyone in a foreign country is an *invisible export.* If you sell 10 shares of stock of an American corporation at $100 a share to an Englishman, the transaction results in the transfer of an invisible right to the Englishman. In exchange you receive $1,000 just the same as

if you had sold him that much merchandise. The transfer of the right to 10 shares of stock of an American corporation is an example of an invisible export.

Likewise, anything other than tangible goods purchased abroad by someone in this country is an *invisible import.* For example, when an American pays for shipping services that have been rendered by an English steamship company or when American tourists spend their money while traveling in Europe, the transaction is a type of invisible import. In both cases the purchase of services by Americans causes money or credit to move from this country to another country in the same way as if merchandise had been purchased abroad.

Favorable and Unfavorable Balances of Trade. It is sometimes said that a country has a *favorable balance of trade* if the value of its visible exports exceeds the value of its visible imports. Conversely, it has an *unfavorable balance of trade* if the value of the visible imports exceeds the value of the visible exports. Many people feel that it is desirable for the United States to have a favorable balance of trade and that it should be the policy of the Federal Government to encourage an excess of merchandise exports over merchandise imports.

As we shall see, however, it is necessary in the long run for each nation to import either goods or services—either visible or invisible items—equal in value to those that it sells. It is not so important that we in the United States, for example, sell more merchandise than we buy from those in other nations. But if we sell more merchandise than we buy, we shall have to buy invisible items to the extent of the difference between the value of our exports and imports of visible items. If we do not, those in other nations will eventually have to stop trading with us, because there would be no way by which they could pay for any goods we might wish to sell them.

The idea that an excess of merchandise exports over imports promotes the welfare of a country is an ancient fallacy. This was a fundamental idea of mercantilism, which held that gold was the most important kind of good. And, according to the mercantilists, one of the best ways by which a nation could obtain gold was to sell more merchandise than it bought.

When we sell more goods to other countries than we buy from them, our invisible imports are usually greater than our invisible exports. Many of our goods may be carried in foreign ships, and thousands of our people may be traveling in other countries, spending money for hotel accommodations, train fares, food, and other things. Hence, money or credit will be due to the other countries for these invisible items.

For many years before the war, the total of all our visible exports was greater than that of our visible imports, but the value of our invisible imports was greater than that of our invisible exports. The fact that the amount of our invisible imports was so large enabled other nations to trade with us as easily as they did. For if other nations cannot sell us goods or services, they cannot continue indefinitely to buy from us.

The statement below illustrates the nature of the two general classes of foreign trade.

SIMPLIFIED STATEMENT OF EXPORTS AND IMPORTS OF COUNTRY A, FOR A YEAR

(In Millions of Dollars)

EXPORTS		IMPORTS	
Visible		*Visible*	
Merchandise	$5,240	Merchandise	$4,100
Invisible		*Invisible*	
Shipping and freight services (by people in Country A for foreigners)	200	Shipping and freight services (by foreigners for people in Country A)	900
Tourists' expenditures (by foreigners in Country A)	180	Tourists' expenditures (by citizens of Country A in foreign countries)	800
Immigrant remittances, charity, etc. (by foreigners to Country A)	20	Immigrant remittances, charity, etc. (by people in Country A to other countries)	280
Interest, debts on borrowed money, and dividends (paid by foreigners to investors in Country A)	900	Interest, debts on borrowed money, and dividends (paid to foreigners by people in Country A)	400
			$6,480
		Excess of total exports over total imports	60
Total	$6,540	Total	$6,540

Under the conditions indicated, Country A would have a favorable balance of trade, in so far as visible items are concerned, of $1,140,000,000 (deduct $4,100,000,000 from $5,240,000,000). But, when both visible and invisible items are considered, the total favorable balance amounts to only $60,000,000. If all the nations were on the gold-exchange basis, the difference in the values of total exports and total imports could be settled by the shipment of gold to Country A. Or the banks in Country A that handle international payments might extend credit to the banks in the other countries that handle international payments for those countries.

As we shall see later, a nation that is on the gold standard must ship gold abroad to pay for the total excess value of imports over exports. If gold is not available, the banks in the nation must, if possible, borrow funds with which to make payment. And, if they cannot borrow the funds needed, the business concerns in the nation must reduce their trade with other nations.

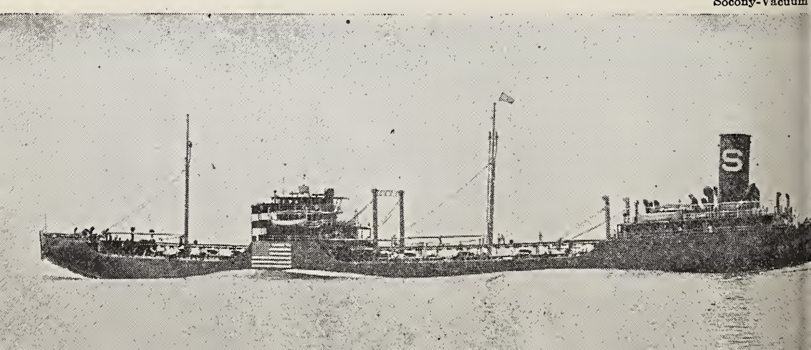
How Can Gold Be Used in Foreign Exchange? Let us make use of a simple illustration for the purpose of gaining a clearer idea of the principles that underlie the use of credit and money in settling international debts. We shall assume that the nations concerned are on the gold standard.

In 1930 both the United States and England were on the gold standard. At that time the pound was equal to $4.8665. If an American owed an Englishman a debt, he would probably pay him in terms of pounds, because dollars do not circulate in

An Oil Tanker

Goods move from one country to another, which gives rise to international payments.

Socony-Vacuum



England. For example, if an American owed an Englishman $4,866.50, the Englishman would consider the amount to be 1,000 pounds.

Now let us see how an American exporter receives payment for goods he sells to a business concern in a country—England, for example—where the monetary unit is different from ours.

Suppose that Adams in New York sells typewriters valued at $4,866.50 to Pembroke in London. In English money this means Pembroke will have to pay £1,000 for the typewriters. But Adams does not want pounds; he wants dollars. And here is where banks enter into the transaction.

When Adams ships the typewriters, he obtains from the steamship company a bill of lading, which Pembroke must have before the steamship company will deliver the shipment to him. Adams now draws a draft on Pembroke for $4,866.50 ordering him to pay the amount to a London bank named in the draft. He takes both the draft and the bill of lading to the Third National Bank in New York and offers to sell the draft to the bank. The New York bank, knowing that Pembroke cannot have the typewriters until he pays for them, is willing to pay as much for the draft as it can collect from Pembroke, less, of course, a slight fee, which we shall disregard here. The bank pays Adams $4,866.50 and receives the bill of lading as security for payment by Pembroke.

The Third National Bank now sends the draft and the bill of lading to the London bank with which it customarily has dealings. The London bank presents the draft to Pembroke, who accepts it and pays the bank £1,000. The bank gives the bill of lading to Pembroke, who can now obtain the typewriters from the steamship company.

The £1,000 held by the London bank belongs to the Third National Bank. How does the latter finally get back the $4,866.50 that it paid to Adams? Of course, the London bank could ship an amount of gold equal to $4,866.50. But that would be cumbersome and somewhat expensive. For that reason gold would not likely be used. If the New York bank really wanted to receive payment in dollars at once, it is more likely that the London bank would make payment by draft. Now let us see how this could be done.

Suppose that at about the same time the transaction described above was taking place, Stephenson in London sold Macey in New York a shipment of woolens valued at $4,866.50, or £1,000. Stephenson would draw a draft for $4,866.50 and sell it to the London bank, which, in turn, would send it to, let us say, the City National Bank of New York. The latter would then collect the amount from Macey.

Now, as we see, the London Bank holds £1,000, which belongs to the Third National Bank. And the City National Bank holds $4,866.50 that belongs to the London bank. Therefore, if it desires to do so, the London bank can draw a draft for $4,866.50 on the City National Bank and send it to the Third National Bank. When the City National Bank pays the draft, both accounts will be settled.

The above examples are simple illustrations that show the principles that are involved in making international payments. By imagining thousands of transactions involving scores of countries and the banks in those countries, you will see that making international payments is a complex process. At the same time, the underlying principles are simple.

The Rate of Exchange. The *rate of exchange* between two countries is the ratio at which the monetary unit of one country exchanges for a monetary unit of the other. For example, if £1 is equal to $4.8665, the rate of exchange is 1 to 4.8665. When two countries are on the gold standard, the rate of exchange is the ratio between the weight of the gold in one monetary unit and that of the other.

For many years the weight of the gold dollar was 23.22 grains and that of the English pound sterling, 113.0016 grains. Now if you divide 113.0016 by 23.22, the quotient is 4.8665. That is the reason why for many years the value of a pound sterling was about $4.86. This was the *gold rate of exchange;* that is to say, it was the value of dollars and pounds in terms of the gold content of each unit of money.

Gold Shipping Points. Now as long as the two countries were on the gold standard, the price of dollars in terms of pounds, and of pounds in terms of dollars, could not change much from the

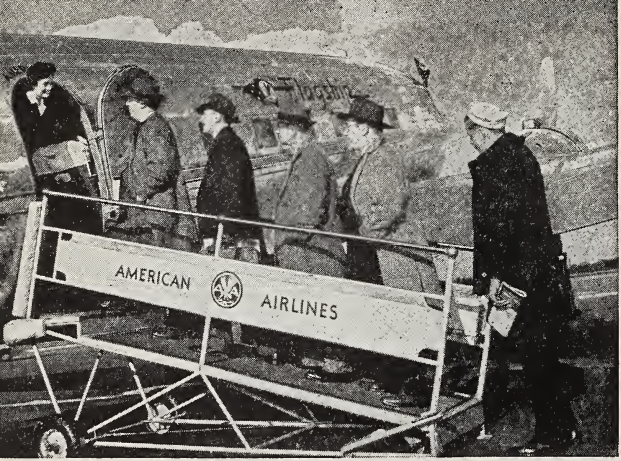
gold rate of exchange. The reason for this can be illustrated by an assumed example.

Suppose that England and the United States are on the gold rate of exchange, that a pound sterling is worth $4.8665, and that you owe Wilson, an Englishman, 100 pounds. You could go to your bank and buy a draft on an English bank for 100 pounds, which would cost you $486.65, plus a small fee. The reason why the bank could sell you the draft would be that the bank has funds in the English bank that resulted from American exports. Now if the amount of funds in the English bank belonging to the American bank was small, so that the American bank wanted to charge you, say, $495 for the 100-pound draft, you would not have to pay it. For you could buy the gold at the gold rate of exchange, $486.65, and ship it to Wilson. Supposing that it would cost you $4 to ship the gold, you can see that you would save $4.35 by doing so.

Therefore, when two countries are on the gold standard, the rate of exchange cannot change more than the expense of shipping gold without causing gold to move from one country to another. The rate that causes gold to move from one country to another is called the *gold export point;* and the rate that causes gold to move into a country is called the *gold import point.*

A rise in the rate of exchange as indicated above would cause people in this country to buy fewer English goods. On the other hand, since a pound sterling is now worth more dollars, Englishmen would tend to buy more American goods. Thus our imports in proportion to our exports would decrease, while our exports would increase. And as our imports decreased, the demand for drafts payable in pounds would become less, which would eventually cause the price of pounds sterling to decline. The influence of the demand for and the supply of credit arising from our exports, together with the increased flow of gold to England, would tend to restore the rate of exchange to that of the gold par.

How Can the Purchasing-Power Rate of Exchange Be Used in Foreign Trade? When two countries are not on the gold standard, the ratio between the weight in gold of the two monetary units cannot be used to determine the exchange rates



Boarding an Airliner

Air transportation will result in an increase in international travel, which will cause more people to use the instruments of foreign exchange.

American Airlines, Inc.

between the countries. As long as the two countries are on the gold standard and gold can move freely from one country to another, as we saw above, the value of the monetary units will remain at about the ratio between the gold content of each.

But when the countries are not on the gold standard, the value of the monetary units in terms of each other must be found in some other way. This other way is usually that of determining the *purchasing-power rate of exchange* of the two kinds of monetary units. We can illustrate what this means as follows.

Suppose that in the United States it requires \$4 to buy the same amount of goods of the same general kind and quality as one pound sterling will buy in England. That would mean that the purchasing power of one dollar would be one fourth that of one pound; therefore, if an American wanted to send \$4 worth of purchasing power to an Englishman, he could do so by purchasing a pound draft from his bank for \$4. And an Englishman could send purchasing power to the value of \$4 by buying a draft from his bank that would cost him one pound sterling.

Since 1934 the weight of the gold dollar has been 13.7143 grains of pure gold, while the weight of the pound sterling has remained 113.0016. Therefore in terms of gold a pound is worth \$8.2397. But there have been many restrictions on the shipment of gold between the two countries, as well as between all countries, for a number of years. And the gold rate of exchange has not been in operation since England and the United States abandoned the gold standard. For that reason the rate of exchange has been determined by means other than that of

gold par. To a considerable extent the purchasing-power rate of exchange has influenced the rate of exchange between the two countries.

The War Upset International Trade. The war, which began in 1939, stopped all trade between many nations. The United Nations continued to trade with each other. But the nature of the commodities exchanged and the methods of payment were different from what they were before the war. They continued to buy from and sell to each other some of the goods that had formerly been exchanged between them. But war materials and soldiers took up most of the available space on ships.

As a result of the war much of international trade really became trade between governments, instead of between individuals and business concerns in the various nations. Early in the war, we entered into a *lend-lease agreement* with the other United Nations. Under this arrangement the United States agreed to supply its allies with goods of different kinds that were needed to carry on the war. And other nations on our side of the conflict agreed to supply our army and navy with certain goods that they needed. According to agreement no payment was to be made by any nation for such goods until some time after the war.

How Will Exchange Rates Be Stabilized? Before the war fluctuating exchange rates hindered trade between nations. Those who studied the subject agreed that a better system of international exchange was desirable.

What foreign exchange arrangements will finally be adopted in order that trade between nations can be carried on without fear that a change in rates will bring financial loss? There are some who contend that fair and stable exchange rates can exist only when nations adopt an international gold standard. Those who object to this proposal point out that many nations have practically no gold, while the United States owns most of the gold in the world. Moreover, they remind us that the gold standard was once in use, but it was not always satisfactory.

It has been claimed by some that nations should continue to use their own currencies and to allow the purchasing power

of their currencies to fix exchange rates, pretty much as was done just before the war. Others have proposed the adoption of an international currency and the setting up of an international bank. But several objections to this proposal have been raised. There is no doubt but that a satisfactory arrangement will be worked out. But the solution will require intelligent effort.

International Finance Is Important. The problems of foreign exchange and international trade should be a matter of interest to everyone. Some nations possess superior advantages over other nations in the production of certain goods. Therefore if the peoples in every nation can buy goods produced in other nations, it is possible for more people to have a greater variety and more goods of all kinds.

Moreover, there are several important nations that are dependent upon foreign trade for their existence. If they were compelled to "live at home," the peoples of Europe would suffer a further decline in their scales of living, and the populations would decrease. In order to maintain their populations on a reasonable scale of living, these nations must be able to obtain raw materials and manufactured goods from abroad. And in order to pay for the things they import, they must be able to find a market for the goods they can produce.

When a nation finds that it cannot obtain the raw materials that it needs to manufacture goods and to feed and clothe its population, or if other nations prevent it from exporting its goods, the danger of wars is increased. In many cases in the past, wars have been waged for the purpose of conquering territory from which raw materials could be obtained and for the purpose of securing markets.

Therefore the subjects of foreign exchange and international trade are important for two reasons: (1) they affect the amount and the kinds of goods that individuals may use; (2) and they are deeply involved in all plans and possibilities for world peace.

QUESTIONS ON THE CHAPTER

1. Give examples of each of the following: visible export; invisible export; visible import; invisible import.
2. Is it desirable that a nation have a favorable balance of trade?

3. Why did the mercantilists want an excess of exports over imports?
4. Before World War II why could other nations continue to trade with us even though our visible exports exceeded our visible imports?
5. According to the statement on page 307, for which invisible items did the exports of Country A exceed its imports?
6. For a nation that is on the gold standard, what choices does it have when the value of its imports exceeds the value of its exports?
7. How may gold be used for international payments?
8. How is a bank draft used in international trade payments?
9. Why was the pound sterling worth about $4.86 for many years?
10. When two countries are on the gold standard, why cannot a change in the rate of exchange exceed the expense of shipping gold between the two countries?
11. Give an illustration to show how the purchasing-power rate of exchange operates?
12. What changes in methods of making payments for international trade were caused by World War II?
13. How is the problem of world peace related to foreign exchange and international trade?
14. What is the meaning of each of the following terms?

(a) **exports**
(b) **favorable balance of trade**
(c) **gold export point**
(d) **gold import point**
(e) **gold rate of exchange**
(f) **imports**
(g) **invisible export**
(h) **invisible import**
(i) **Lend-Lease**
(j) **rate of exchange**
(k) **unfavorable balance of trade**
(l) **visible export**
(m) **visible import**

APPLICATIONS OF THE CHAPTER

1. Report on a magazine or a newspaper article dealing with foreign exchange.
2. Discuss the reasons why the United States went off the gold standard in 1933 and the effect of the suspension of the gold standard on rates of exchange.
3. Discuss the effects of a suspension of the gold standard on exports, imports, and tourist travel.
4. It is usually said that we export only about 10 per cent of the goods produced in this country. Give a report on the percentage of exports of the following goods: cotton, petroleum, machinery, fruit and nuts, automobiles, tobacco, wheat.

5. Consult the *World Almanac* for the value of the monetary units of various countries. From the financial pages of a large newspaper, ascertain the exchange rates for several countries.
6. European nations owe the United States Government several billions of dollars. Discuss the ways by which the amount could be paid. What would be the effects on manufacturing and labor if the amount were paid in goods? Could the debts be paid in gold? How else could they be paid? What would be the effect of such payment?
7. It has been said that the position of a creditor nation is different from that of a debtor nation. What is implied by this statement? Is it necessary for a creditor nation to import goods? Why?
8. Why do exports usually increase when a nation goes off the gold standard or otherwise devalues its money? What bad effects with regard to foreign trade may follow devaluation? What good effects may follow?
9. Can a nation obtain too great a proportion of the world's gold for its own good? Why?
10. Show how international settlements of debts may be made without the use of gold.
11. Explain how dealers in foreign exchange build up credits in other countries.
12. Show how imports tend to decrease credits in foreign banks.
13. Explain what is meant when the pound sterling or the dollar is selling "below par" or "above par" in foreign markets.
14. Give arguments for and against an attempt to maintain a favorable trade balance continuously.

TOPICS FOR SPECIAL REPORTS

1. The money value of our most important exports and imports.
2. How many dollars at the present rates of exchange would be required to pay a debt of one thousand pounds, of one thousand francs, or of one thousand lire.
3. How and why we have become a creditor nation.
4. Lend-Lease during World War II.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should it be our policy to try to maintain a favorable balance of trade?
2. Should European countries be required to pay the debts owed to us as a result of World War II?

CHAPTER 20

CHANGES IN PRICES AND MONEY VALUE

If your father receives as much money this year as he did last year, is his income the same? The answer depends upon whether we mean money income or real income. Of course, his money income is the same. And his real income is the same, provided he can buy as many goods of an equal quality as he could have bought with the same amount of money last year.

One's money income can be figured pretty accurately. But the amount of money received during a given time is not the only important matter to be considered. The prices of the things that are to be bought with the money are quite as important.

Price Changes Are Important. The fundamental reason why changes in prices are important is that the prices of all commodities and services do not change in the same way or at the same time. For example, the price at which the farmer sells his wheat during this year may be much higher than that at which he sold it last year, but the prices of some of the commodities and services that he buys may be lower or higher than they were before. If all prices, including wages, salaries, and interest, as well as the prices of goods and services, changed equally at the same time and in the same direction, a change in the price of a particular commodity or service would not be important. If, for example, your salary was $100 a month and all prices, as well as your salary, increased 100 per cent, you could still buy as many goods and services as before. But if your salary remained at $100 while prices increased 100 per cent, you could buy only one half as much as you could before other prices increased.

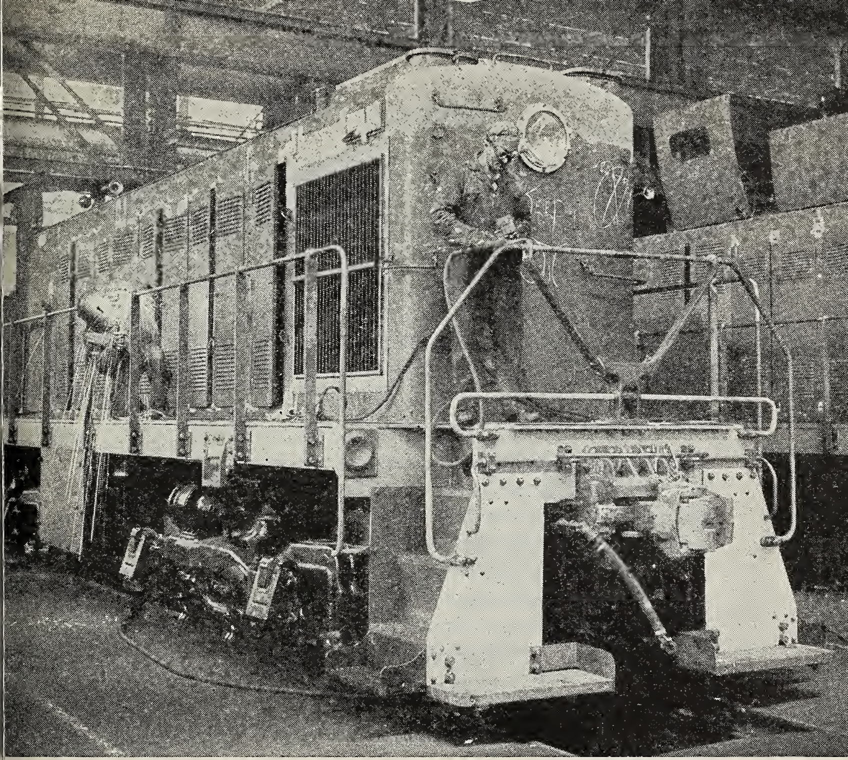
The Effect of Price Changes on the Value of Debt Payments. Changes in prices cause debtors to repay a different amount of

purchasing power from that which they borrowed. For example, in 1944 prices of things that consumers ordinarily buy rose about 25 per cent above the average for the period from 1935 to 1939. This meant that in 1944 it took nearly $125 to buy as much as $100 would have bought a few years previously. Suppose, then, that a few years before, John Moore borrowed $100 and agreed to repay this amount in 1944. As we have seen, what he really borrowed was that much purchasing power. Because of the increase in prices, the $100 in money that he later repaid (disregarding the interest on the loan) went about as far in defraying the cost of living as did $80 in the years before 1939. In other words, Moore returned a considerably smaller amount of purchasing power than he borrowed.

The Effect of Price Changes on the Value of Fixed Incomes. There are many people who receive fixed incomes, such as interest on bonds, rent from long-term rental contracts, or pensions. Suppose, by way of illustration, that a widow received $50,000 in insurance money when her husband died and that she invested it in bonds at 3 per cent interest. If prices doubled, as they actually did from 1913 to 1919, the $1,500 income that she would receive would buy only half as much as it would have bought before. In other words, $1,500 would be worth no more than $750 was before the increase in prices took place.

People who are dependent upon pensions from governments or from industrial and business concerns are likewise affected by price changes. All persons with fixed incomes—whatever the sources of such may be—suffer a loss in purchasing power when prices rise. On the other hand, they benefit from a fall in general prices.

The Effect of Price Changes on the Value of Wages. As general prices increase, there is a tendency for earnings from wages also to increase. But wages almost always lag behind changes in the prices of commodities. A hardship is therefore imposed upon wage earners when prices are rising, because the earnings from wages do not keep pace with the increase in the cost of living. On the other hand, when prices start declining, wages do not immediately decrease. For that reason, until the



American Locomotive Company

Welder and Grinder at Work on Diesel-electric Locomotive

These men receive a certain rate of pay per hour for their services. Like the incomes of all other persons, however, the value of the money wages they get depends upon how much the money will buy at the time.

decline in wages catches up with the decline in prices, the wage earner is better off than he was before prices began to decline.

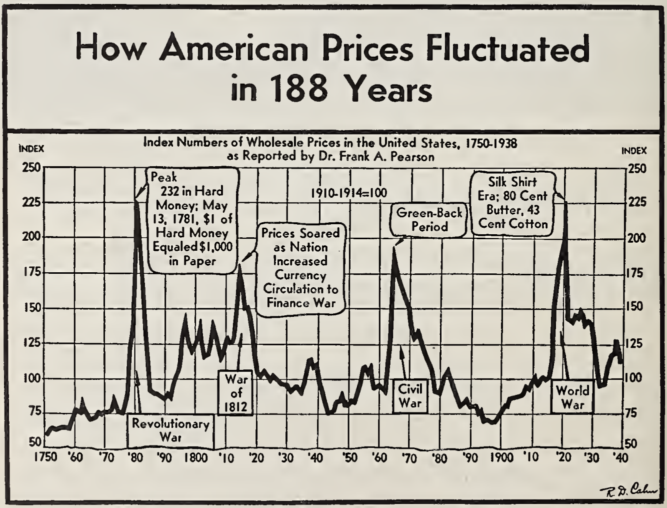
The Effect of Price Changes on Value of Profits. Business-men usually favor rising prices. As prices increase, larger profits are made on goods that were bought when prices were lower. On the other hand, a decline in prices is looked upon with disfavor because selling prices are lower than they were expected to be when the goods were purchased for stock.

But unless employment increases as prices rise, business will not continue to prosper. Eventually prices will have to fall because consumers cannot buy as much as when prices were lower unless wages also increase. The wage-earning group

makes up the vast majority of the population of the country. Therefore, unless the wage-earning group can purchase the goods that are manufactured and offered for sale, manufacturers and merchants cannot make profits.

Of course, rising prices affect the purchasing power of the money received as profit by business individuals and concerns. But until rises in the prices of wages and the other elements of cost or expense in the operation of business enterprises overtake the increase in profits, the amount of profit is usually larger proportionally than the increases in wages.

The Effect of Price Changes on the Value of Investments. Price changes affect investors in bonds and stocks. As we recall, the income from bonds is fixed at a certain percentage. As long as bondholders feel reasonably sure of their interest and of the security of the principal, the prices of bonds do not decrease greatly when general prices fall. On the contrary, they are likely to increase. Bond prices are more stable than stock



The History of Prices Before World War II Chicago Tribune

What classes of persons were affected by the rise in prices in 1780, 1814–16, 1864–65, 1920? Who derives the most benefits from the increase in prices?

prices because bonds pay a stipulated amount of interest. The purchasing power of bond interest increases, therefore, when prices fall, and the prices of bonds tend to increase. Of course, if there is uncertainty as to whether the interest will be paid as it becomes due, there may be a violent decline in the prices of the bonds.

The foregoing tendencies are true also of preferred stocks, the income from which is usually limited somewhat like the income from bonds. If a preferred stock is participating, the amount of dividends may increase and the price of the stock may consequently rise as profits increase.

Common stocks, however, are very susceptible to changes in the prices of commodities in general. This is explained by the fact that the income from common stock, in the form of dividends, depends directly upon the profits earned by the corporation. Since rising prices tend to result in greater profits, the demand for common stocks increases when there is an increase in general prices. But when commodity prices are declining, the prospects for profits dwindle, and the prices of common stocks therefore fall.

The Effect of Price Changes on Amounts of Investments. The effects of changes in commodity prices are also reflected in the amounts invested in capital goods. When prices are rising, producers become optimistic and invest increasing amounts of capital in buildings, machinery, and other equipment. If prices continue to increase, the added investment may prove profitable. But if prices decline and widespread unemployment results, there will be a decreased demand for the products that the added capital was intended to produce. In that event, the investments may result in losses.

Hence, it is easy to see why building of all kinds by private concerns increases in periods of rising prices and prosperity and decreases in periods of falling prices. Beginning in 1933, the National Government adopted a policy of trying to change the natural tendency for construction work to decrease in periods of low prices and bad times. Billions of dollars have been spent through the PWA and other governmental agencies in order to create employment in various lines of construction work.

The Effect of Price Changes on Governmental Expenditures. Price changes also affect the activities of the various divisions of government, besides those not designed to create employment. The budget, containing estimates of income and expenditures, is prepared in advance. The appropriations to be made by the legislative body are estimated on the basis of the income, or revenue, to be received. If prices increase, the given amount of an appropriation will not go so far as it would have if prices had not risen. But if prices decrease, the amount of the appropriation will go farther than was expected.

Another effect of changes in the price level with regard to government is noticeable in the collection of revenue. If the government relies for part of its revenue upon a certain rate of taxation on income, the amount collected will tend to vary as individual and corporate incomes increase or decrease. As the incomes of individuals and corporations are determined largely by the prosperity of business, the amount of revenue collected may be much larger or much smaller than was anticipated, depending upon whether business was good or bad during the tax period.

During World War II the cost of living rose, in spite of the efforts of the Government to prevent it by means of "rationing" and "ceiling prices." Of course, the rise in the prices of materials and wages added greatly to the cost of the war.

Price Changes Are Measured by Index Numbers. When we consider a particular commodity, as wheat or sugar, we can easily compare the price at one date with that at another date. And so far as one commodity is concerned, we can say without any difficulty whether the value of money in terms of that commodity has changed. But when we wish to know whether the purchasing power, or value, of money in terms of many commodities has changed, we encounter a more difficult problem. The prices of some commodities may be lower than they were previously, while those of others may be higher.

Various methods have been devised for estimating price changes. All of them, however, attempt to find the "average value" of money at a particular time in comparison with the "average value" at another time. The simple arithmetical average illustrates the principle of all the methods used in

Effects of Changes in Prices

When Prices Increase—

A debtor repays a smaller amount of purchasing power.

Those with fixed incomes suffer a loss in purchasing power.

Wages tend to increase but less rapidly than prices.

Profits tend to increase more rapidly than prices.

Common stock prices tend to increase; most bonds and preferred stock prices do not increase much.

Investments in capital goods increase.

Appropriations for government expenditures buy less; government revenues are greater than anticipated in budgets.

When Prices Decrease—

A debtor repays a greater amount of purchasing power.

Those with fixed incomes have increased purchasing power.

Wages tend to decrease but less rapidly than prices.

Profits tend to decrease more rapidly than prices.

Common stock prices tend to decrease; most bond and preferred stock prices tend to increase.

Investments in capital goods decrease.

Appropriations for government expenditures buy more; government revenues are less than anticipated in budgets.

A Summary of the Effects of Price Changes

determining the purchasing power of money at one date in comparison with that at another date.

When fluctuations in the value of money are to be determined, two dates are selected, one of which is called the *base date.* Then the increases and the decreases in the prices of the commodities chosen for comparison are averaged in terms of percentage. The resulting figure is thus a percentage, showing whether the average value of money is higher or lower than it was at the base date. This figure is called a *price index number.*

Since the index number is a percentage indicating the change in the average price of a number of commodities, the average price for the base year is 100 per cent. If the average price has increased 10 per cent, the index number is 110. If there has been an average decrease of 10 per cent, the index number is 90.

An Example of a Simple Index Number. A brief example using the simple arithmetic average method will make clearer the principle followed in calculating index numbers. In order to keep the illustration as simple as possible, we shall use the prices of only five commodities. In the illustration the prices of all the commodities except that of eggs rose during the period. To obtain the *base index number,* we assume that the price of each commodity in 1939 is 100 per cent. We then add the percentages and obtain 500, which divided by 5 gives 100, the average for the entire group of commodities. We then calculate the index number for 1945 by dividing the 1945 price by the 1939 price, and multiplying the quotient by 100, which gives the price index number for that commodity. The price index numbers are added together and the total is divided by 5, the number of commodities, which gives the average or price index number for all the commodities for 1945.

CALCULATION OF A SIMPLE ARITHMETIC AVERAGE INDEX NUMBER

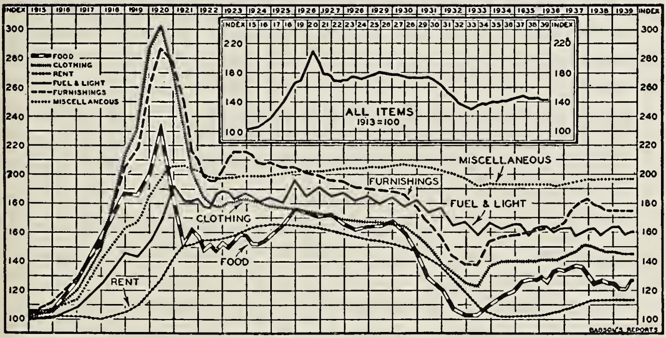
	January 1, 1939		January 1, 1945	
Commodity	Base Unit Price	Base Index Number	Price	Percentage To Base Index Number
Eggs	$ .60	100	$ .55	91.7
Meat	.40	100	.60	150.0
Suits	25.00	100	35.00	140.0
Rent	35.00	100	40.00	114.3
Bread	.10	100	.11	110.0
		5)500		5)606.0
	Average Index Number	100	Average Index Number	121.2

NOTE: Calculate percentage to base index numbers as follows, using eggs as an example: $(.55 \div .60) \times 100 = 91.66$

Thus we find that the same amount of money would purchase a smaller total quantity of all the commodities on January 1, 1945, than it would have purchased on January 1, 1939. That is to say, it took $1.21 in 1945 to buy as much of these five commodities as one dollar would buy in 1939.

Other Indexes of Price Levels. Use of the simple arithmetic-average method of calculating price index numbers enables us to get an idea of the effects of changes in prices of commodities and the value of money. It is not generally considered so desirable as some other more involved methods. Some of the more complex formulas attempt to take into consideration the relative amounts spent by people for various kinds of commodities, a provision that tends to make the index numbers thus obtained more accurate and reliable. For the purpose of illustrating the nature of index numbers, however, the illustration given above is adequate.

Several organizations in the country attempt to figure price levels by the use of various formulas. All of them make use of the prices of many commodities. The Bureau of Labor Statistics, at Washington, which is the most frequently quoted authority

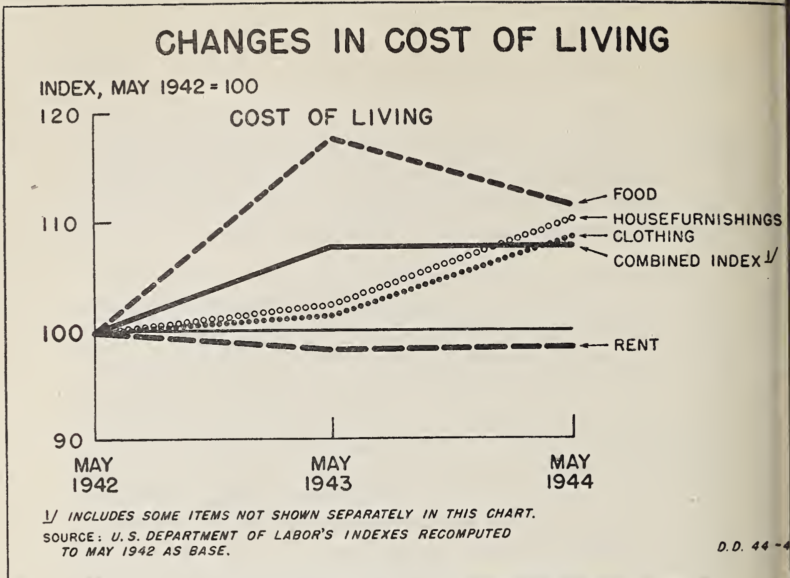


Source: U. S. Dept. of Labor, 1913=100. Latest figures estimated.

Courtesy of Babson's Reports

Cost of Living Index, 1913–1939

The chart shows the changes in the market prices of those classes of goods that determine the cost of living. The year 1913 is taken as the base year, and prices at later dates are compared with those in 1913.



Cost-of-Living Changes During World War II

in the country, uses the prices of several hundred different commodities in its method of calculating index numbers.

What Is the Quantity Theory of Money? Do prices depend upon the amount of money in circulation? Do prices in general change because the amount of money in circulation changes? There are those who say that the price level—prices in general—depends upon the amount of money in use. That is to say, an increase in the amount of money will result in a proportional increase in prices; and a decrease in the amount of money in circulation will cause a corresponding decrease in prices. Or, as it is sometimes said, prices vary directly with the amount of money, while the value of money varies inversely with the amount in circulation.

The above is a simplified statement of an explanation of price changes that is frequently given by those who hold to what is popularly referred to as the *quantity theory of money.* Those who accept the idea that the amount of money in circulation is the determining factor in price changes recognize that other factors are involved. But they feel that the important factor is the quantity of money.

Does the Quantity of Money Determine Prices? Before we venture an answer to this question, let us consider the factors that are involved in the prices of things in general. There are five such factors as follows:

(1) *The amount of money in circulation.* This amount includes both coins and paper money of various kinds. It does not include money held by banks as reserves and money held in the treasury of the United States.

(2) *The velocity of the circulation of money.* This is the number of times the money in circulation changes hands in a given period of time, such as a month or a year. The velocity is found by dividing the total value of all transactions for the time period by the number of dollars in circulation. The importance of the velocity of circulation can be appreciated when we realize that a small number of dollars that move rapidly from person to person may take care of as many transactions as a much larger number of dollars that move more slowly. For example, a dollar bill that changes hands fifty times in a year will take care of fifty times as many transactions as a dollar bill that is used in only one transaction in a year.

(3) *The volume of demand bank deposits.* As you have learned, these are bank deposits that are subject to withdrawal by check. Bank credit as provided by such deposits is used as a substitute for money in many present-day business transactions. It must therefore be considered in determining the effect of changes in the quantity of money upon prices.

(4) *The velocity of the circulation of demand bank deposits.* How frequently bank credit is used is as important a factor in relationship to the volume of bank credit as the frequency of the use of money is in relationship to the amount of money in circulation. In other words, we cannot determine the effect of the volume of demand bank deposits on prices unless we know how frequently that amount of bank credit is used.

(5) *The total volume of transactions.* This is equal to the physical volume of trade and includes goods, services, and corporation securities.

It is generally agreed that all these factors are involved in the determination of prices. But which is cause and which is effect? Those who do not accept the theory that changes in

prices are always the result of changes in the quantity of money in circulation say that the factors—money, the velocity of money, bank credit, the velocity of bank credit, the volume of trade, and prices—are all interrelated, and that each depends largely upon each of the other factors. In fact, some claim that prices can change without any change in the amount of money in circulation, and that a change in prices may result in a change in the amount of money. And they cite examples in the history of money and prices to prove their argument.

Without attempting to explore all the angles to the question, we may state the following conclusions, which are accepted by most people who have seriously studied the subject of the causes of changes in the price level: (1) Over a long period of time—a year or two years to a decade or more—a change in the amount of money is very likely to result in a change in prices, although the change may not be exactly in proportion to the change in money. (2) Over a short period of time, say, a period of several weeks or months, an increase or a decrease in money in circulation may have little effect on prices.

As you can see, it would be a mistake to think that we can control prices quickly and easily simply by changing the amount of money. While the amount of money in circulation does tend to influence prices, there are other factors that must not be overlooked. Therefore if an intelligent effort is to be made to control prices, attention must be given also to such matters as the amount of bank credit, the willingness of people to use their money and credit, and the amount of goods and services that are available for trade.

Can Prices Be Controlled? Most people agree that price changes result in more evil than good. They think that fluctuations in the price level should be eliminated if possible. Accordingly, various proposals have been put forth to eliminate, or at least to minimize, changes in the price level.

The Compensated Dollar. One suggestion for controlling changes in the general price level is that of the *compensated dollar*. In brief the proposal is as follows:

1. At any time the dollar would consist of a certain amount of gold, but this amount would not be fixed.

2. Gold would not be coined. The United States Treasury would keep a supply of gold and would issue certificates that would be redeemable in gold. The metal could be used for commercial purposes.
3. If the price level rose, the amount of gold in the dollar would be increased by the same percentage. Likewise, a decrease in the price level would call for a proportionate decrease in the gold content of the dollar.

To illustrate the working of the theory of the compensated dollar, let us assume that the price level for 1940 has been determined and let us use 100 per cent to represent that price level. Assume also that for that year the gold in the dollar is 13.71 grains. Ever so often, say once a month, the price level would be calculated. Then, if prices increased 1 per cent, and the price level thus became 101 per cent, the amount of gold in the dollar would be increased 1 per cent, or to 13.847 grains.

As the amount of gold in the world cannot be increased rapidly and is therefore, in a sense, limited, the amount of money issued would decrease as prices increased. It is claimed that the amount of bank notes would also decrease accordingly, for the bank notes would have to be backed by a reserve of gold. Because the money that could be issued would become relatively scarcer, prices would, it is said, decline to their former level.

Managed Currency. Another proposal that has been made calls for the abandonment of the gold standard. According to this proposal the National Government would be authorized to issue only paper money. As the price level tended to rise, the amount of money issued would be reduced; and, conversely, as the price level decreased, the amount of money issued would be increased. This proposal is known as *managed currency.* As the name implies, the plan would rely upon adjusting the supply of money so as to establish a stable price for commodities taken as a whole.

In order to give the Government full control over the quantity of all money and credit, the Federal reserve banks would be required to raise discount or interest rates when prices were rising, so as to discourage merchants and other businessmen

from borrowing as much as they would if the discount rates were lower. The banks would likewise be required to decrease the rates when prices were falling. A decrease in the discount rates, it is said, would encourage the borrowing of funds for use in the purchase of goods and the operation of industries. Thus, it is claimed, prices would tend to rise.

The Tabular Standard. The *tabular standard* refers to a proposal to control the effects of changes in prices. It is intended primarily not to prevent changes in the price level, but rather to prevent a change in the purchasing power of the amounts of money named in contracts.

For example, suppose that the tabular standard were in use and that I borrowed $100 from you in 1944, when the price level, we shall say, was represented by an index number of 100. Then, if I were to repay you in 1945, when, let us assume, the price level had risen to 105, I would pay you $105 because $105 in 1945 would buy only as much as $100 would have bought in 1944. Or suppose that I employ you at a salary of $100 a month, beginning on January 1. By August 1 the price level has risen perhaps to 101. Your salary will then be increased to $101.

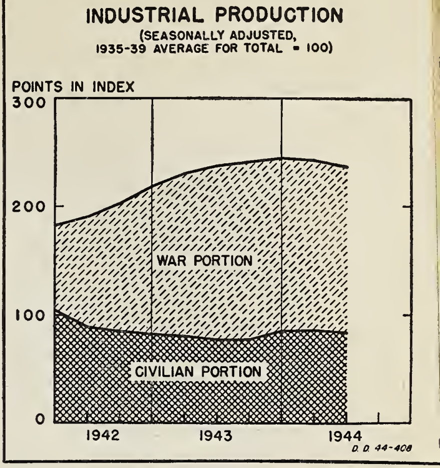
If accurate index numbers could be worked out, the adoption of the tabular standard might overcome many instances of injustice due to fluctuations in the price level.

War Made Efforts to Control Prices Necessary. Even before we entered World War II, prices began to rise rapidly. The reason was that huge expenditures were being made in preparation for war. Many of our factories were turning out planes, tanks, ammunition, and other war supplies. Then in 1940, when it appeared that we might be drawn into the war, our Government appropriated several billions of dollars for the purpose of rearmament. By 1943 the appropriations of the Government amounted to more than 150 billions, most of which was to be spent on war.

The huge increases in the amount of money that people had to spend, and the fact that there were fewer goods to buy, caused prices to go up. In 1940 efforts by the Government to control prices were begun. In 1941 the *Office of Price Adminis-*

The Effects of War on Production and Prices

In 1943-44 nearly two thirds of all the goods produced in industrial plants in the United States were used for the purpose of carrying on the war. Almost full employment for all available workers, usually at good wages, increased total purchasing power; while goods for civilian use decreased in amount. This condition caused prices to rise.



tration was created. The OPA was given power to control rents and the prices of practically all goods and services sold by regular dealers and others.

Prices. Various methods were used at different times by OPA to control prices. Finally ceiling prices for many of the articles sold by retail stores were established. Each retailer was required to post a list of the highest prices he was allowed to charge for the articles in his store. If he charged more, he violated the law, and his customers were expected to report the violation to the local Price and Rationing Board.

At the same time the War Labor Board attempted to limit increases in wages. And an effort was made to put ceiling prices on some farm commodities.

Rationing. In order to prevent hoarding and to make it possible that everyone would be able to get a portion of the supplies of goods, rationing was adopted by OPA. At first only typewriters, fuel oil, gasoline, automobile tires, workmen's rubber footwear, bicycles, sugar, and coffee were included on the list of rationed articles. But before long the list was extended to include processed foods of most kinds, fats, shoes, cooking and heating stoves, meats, and some other things.

Consumers were required to register at their local Price and Rationing Board and obtain ration books containing coupons that would entitle them to purchase certain amounts of certain goods within specified times. Later, tokens, in the form of round discs about the size of a small coin, were also issued to

be used for the purchase of meats and processed foods. With each purchase of a quantity of a rationed article, the buyer was required to give the retailer one or more coupons or tokens.

The Work of the OPA. At the start the work of the OPA required the services of more than 255,000 persons, of whom more than 250,000 were volunteers. After the consumers had registered and the system was established on a more or less permanent basis, more than 50,000 paid employees were needed. In 1944 the funds appropriated for the use of OPA amounted to $155,000,000, or about $1.14 for each man, woman, and child in the nation.

Although there were some complaints, most people agree that price ceilings and rationing prevented runaway prices and hoarding. OPA could not prevent some increases in prices. Besides there were many "black markets," where bootleg sales of rationed articles were made. But in spite of these things, the work of the Government in controlling prices met with the general approval of the people.

QUESTIONS ON THE CHAPTER

1. What is the main reason why changes in prices are important?
2. What changes in prices occurred in 1944 and the years just preceding?
3. What classes of people are not benefited when prices rise?
4. Do wage earners gain or lose when prices decline?
5. Why do businessmen usually favor rising prices?
6. Why do stock prices fluctuate more than bond prices?
7. Why was the Government particularly interested in promoting construction after 1933?
8. How do price changes affect the financial plans of government?
9. How is an index number calculated? Give an example of the calculation.
10. What is the advantage of a more involved method of determining index numbers such as the one used by the Bureau of Labor Statistics?
11. What factors other than the amount of money in circulation affect prices?
12. Why is the velocity of the circulation of money an important factor in determining the effect of the amount of money in circulation on prices?
13. Why must bank credit be considered in relationship to price changes?

14. Upon what two points does there seem to be general agreement concerning the quantity theory of money?
15. What proposals have been made to control price changes?
16. Distinguish between the "compensated dollar" and "managed currency."
17. How did the war affect prices? Discuss the work of the Government in its attempt to control prices.
18. What is the meaning of each of the following terms?

(a) **compensated dollar**	(d) **price index number**
(b) **managed currency**	(e) **quantity theory of money**
(c) **OPA**	(f) **tabular standard**

APPLICATIONS OF THE CHAPTER

1. Report on a recent magazine or newspaper article dealing with the subject of price changes.
2. Discuss some local problem that has to do with changes in prices.
3. Assume that the price level is now 100. What would happen if by this time next year it had risen to 200? Consider the following: (a) a bookkeeper who is earning $100 a month, (b) a farmer who is selling his wheat at present prices, (c) a farmer who is selling his cotton at present prices, (d) the electric-light or gas company in your city, (e) the grocer, (f) day laborers, (g) a veteran who draws a pension of $50 a month, and (h) an old couple who have an income of $1,200 from interest on bonds. Would the prices of wheat and cotton necessarily double? Which incomes or prices would tend to increase? Which would tend to decrease in proportion to the rise in prices? Which would lag behind?
   If, during the year following the rise in prices, the price level returned to 100, what would be the effect on each of the individuals or groups mentioned above?
4. Is inflation desirable? How can it be brought about?
5. Discuss the problems of price control. (Consider money and credit, price fixing, and the control of production.)
6. How may changes in prices enable some persons to make large fortunes? How may they ruin other persons? Give examples.
7. In 1933 the Government undertook to raise prices to the 1926 level. In order to do this, it devalued the dollar, borrowed huge sums of money for public works, encouraged the making of agreements to fix minimum wages and not to reduce prices, and otherwise lent its aid in an effort to raise prices. What arguments could be advanced in behalf of the efforts of the Government in this respect? What arguments could be given against such efforts?

8. Does the Sherman Antitrust Act tend to prevent price fluctuations? How?
9. Trace the relations between prices in this country and prices in other countries. Do these relations suggest arguments for or against closer agreements with other nations as to international trade? Why?

TOPICS FOR SPECIAL REPORTS

1. Changes in the price level during World War II.
2. The results of the attempt by the National Government to raise prices in 1933 and 1934.
3. What banks can do to prevent fluctuations in the price level.
4. The results that would follow a permanent stabilization of prices.
5. What inflation means.
6. Activities of the OPA.

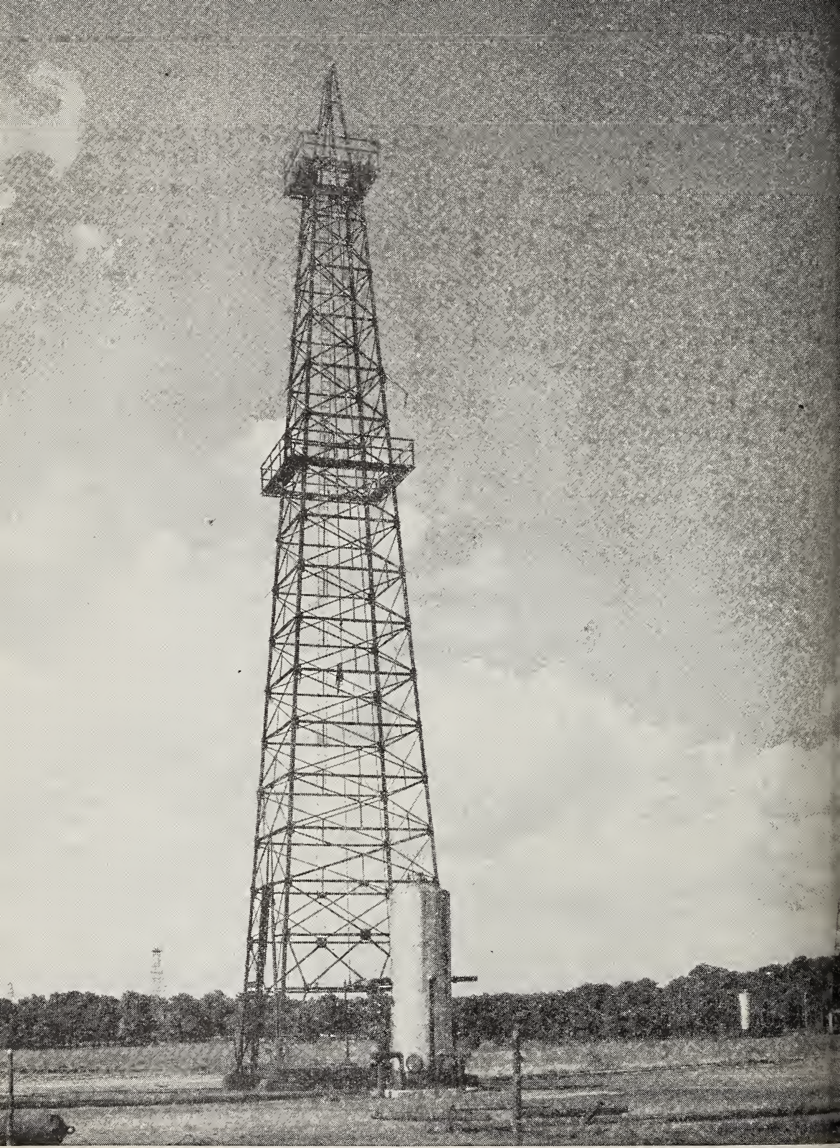
PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Would raising the prices of goods by governmental order stimulate business?
2. Can a managed currency overcome changes in the price level?
3. Do fluctuations in the price level affect the laboring class more than the capitalists?

UNIT VI

Distributing Income

How the incomes
of individuals are
determined.



Standard Oil Co. (

Distributing Income

How much of the income from oil production, and other industries, should each individual contributing to such production receive?

CHAPTER 21

SHARING WHAT WE PRODUCE

The incomes that individuals receive vary greatly. Some people work hard every day, but they seem unable to earn more than enough to live on a very simple scale. Others, who perhaps work no harder, have incomes sufficient to enable them to live in comfortable homes, to wear good clothes, to eat plenty of nourishing food, and from time to time to buy some luxuries. Still there are some others who have incomes that permit them to have nearly any material thing they may desire. Moreover, those in the last group frequently have more leisure than any of the others.

Why do incomes vary so much? Of course, we may say in answer that the work which some do is more important than that of others; or that some own a great deal of property which yields them an income, while others do not. For example, we might say that the work of a janitor or a mechanic in a factory is not so important as that of the president of the concern. And a man who owns a great many stocks and bonds and much real estate receives a large income in the form of profits, interest, and rent. But such explanations do not get to the root of the matter. They do not explain why some kinds of work are more important than other kinds. Nor do they explain what determines the amount of rent, wages, interest, and profits that individuals receive.

In this and the following chapters we shall try to find out what determines the incomes that individuals receive. And in these discussions we shall be dealing with that division of economics known as distribution. As it is used here, *distribution* refers to the apportioning of the wealth that is produced during a given period of time, such as a year, among the owners of the factors that produce it.

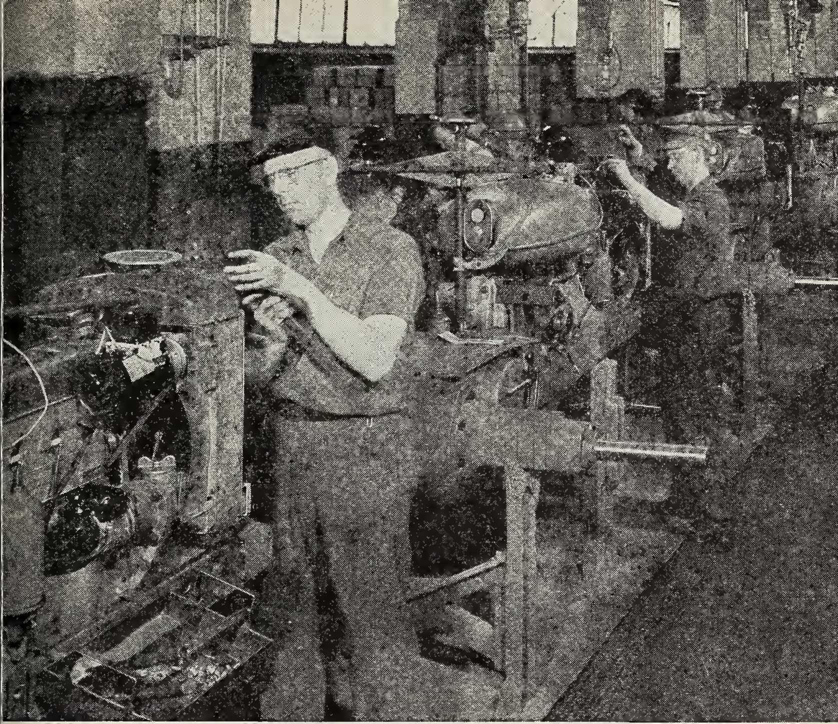
What Are the Shares of the National Income? As we saw early in this course, the four factors of production are land,

labor, capital, and entrepreneurship or risk taking. Day in and day out, those who supply these factors are turning out goods and services. The output of individuals and business concerns consist of corn, wheat, cotton, and other agricultural crops; coal and lumber; manufactured goods of many kinds; the services of teachers, nurses, physicians, and others; and other things in almost endless number and variety. By only a slight stretch of the imagination we can envision a continuous stream of goods and services flowing from our productive establishments that are distributed to and used by the people in the satisfaction of their wants. As we learned in Chapter 2, this stream of goods is known as the *national income.*

The national income is distributed to the owners of the factors used in producing it. The amount that goes to those who supply labor is called *wages*; that which goes to the landowners is referred to as *rent;* that which goes to those who furnish capital is termed *interest;* and the reward received by the entrepreneurs, those who assume the risks of organizing and conducting production, is *profits.*

Money Income Is Power to Obtain Goods and Services. The mechanic in a locomotive factory helps to build a huge machine that will pull freight or passenger cars, but it is impossible for his employer to pay him with a part of the product he produces. Nor can the lawyer pay his secretary by giving her some of the letters she writes. Neither of these workers would have much use for the things they help to produce. Moreover, they need many of the things that other workers are producing.

Therefore those who produce the goods and the services that make up the national income usually receive payments in the form of money. The money they receive is purchasing power, which gives them the privilege of selecting from the national income such things as they want and can afford.



International Harvester Co.

Making Farm Tractors

These men do not raise wheat, nor do farmers make tractors; but all of them eat bread. Is such division of labor beneficial to all concerned?

It would be difficult, if not impossible, to enumerate all the things that make up the annual national income. Even if it were possible, the list would be so long and so complex that it would be meaningless for the purposes of comparison. True, we might compare the amount of cotton or shoes produced in one year with that of another year. But to think in terms of all the products produced in one year and then to compare them with those of another year would be impossible. For these reasons it is customary to state the national income in terms of dollars.

But we should not lose sight of the fact that the national income is made up of goods and services. The power and the right to share in the distribution of the goods and the services produced is distributed in the form of money, and the value of the national income is often stated in terms of money. This distinction should be kept in mind.

Labor Receives Most of the National Income. Unfortunately we do not have exact figures for the total amounts of income received by those who supply each of the four factors of production. From the figures we have, however, we may say that for the years just preceding and during the first years of World War II the average distribution of the national income was as follows: wages, salaries, and social-security benefits, from 65 to 69 per cent; interest, from 5 to 7 per cent; rents and royalties (the latter being payments to authors and inventors), 2 to 4 per cent; profits, from 20 to 25 per cent.[1]

Thus we see that labor, in an average year, receives more than two thirds of the national income. Entrepreneurship receives the next largest portion, not more than one fourth; and landowners, the owners of capital, inventors, and authors receive the remainder.

This does not mean, of course, that individual wage earners and their families receive more than do the individuals and the families who supply the other factors of production. As we know, there are many millions more wage earners than there are owners of businesses and of land and other kinds of property. Moreover, there are great variations between the incomes of each of the classes of income receivers. For example, a corporation executive may receive several hundred thousands of dollars as salary a year (salary is another name for wages), while an individual laborer may receive only a few hundred dollars annually. Likewise an owner of valuable city property may receive rents amounting to many thousands of dollars, while the owner of a small lot or a farm may receive only a few dollars in rent. Therefore the figures for the distribution of the national income according to the classes of income receivers gives no indication as to how much of the national income individuals in these classes obtain.

Money Income May Differ from Real Income. Elsewhere in our study of economics we have learned that the value of money depends upon its purchasing power. And in our consideration of the shares of the national income that is indicated

[1]Source: *Survey of Current Business*, June, 1941, p. 15, and several subsequent issues.

by the wages, the rent, the interest, and the profits that different groups and individuals receive, we should keep in mind that the value, or purchasing power, of money changes. For example, if the total wages of a man for a year is $2,000, he can buy a certain amount of goods with the money. But if the prices of things in general rise 50 per cent, while the amount of his wages remains the same as before, his total wages will buy only two thirds as much as it would before. The effect on his purchasing power would be the same if prices remained unchanged and his yearly wage was reduced by one third. What is true of the value of wages is also true of all the other forms of income.

Demand and Supply Affect the Shares of Income. In our study of how prices of commodities are determined, we learned that, if the supply of a good is limited and the demand is great, the price of the good is high. Now, of course, the factors of production differ in nature from ordinary goods. But in one respect they are like goods that are bought and sold in the market place: they are useful and people are willing to pay for their use.

For this reason rent, wages, and interest may be considered special forms of price. Profits, unlike the other forms of income, are usually a very uncertain form of compensation or reward that goes to the person or persons who assume the risk of organizing and directing the other factors of production.

Under conditions of competition the demand for and the supply of a factor of production determines the share of income that goes to the owner of the factor. But merely to say "demand and supply" is not to give a very enlightening explanation of how any one of the three kinds of income is determined. Although we know that prices tend to vary according to demand and supply, we should like to know why they tend to vary as they do.

Productivity Is Supposed to Determine Income. Anyone who is engaged in producing a good needs land and materials, labor, and capital because these things enable him to make the thing he wants to produce. For example, a manufacturer must have a site for his factory and he must have the right kinds of materials. He must also have employees who can supply labor

of different kinds. And he must have various kinds of machines, tools, and buildings. He expects to sell the goods that are produced in his factory at a price that will yield him a profit. Since he cannot have most of the things needed to carry on his business without cost, the price at which he sells his product must be one that will cover the total of the amounts that he pays for the use of land and materials, labor, and capital, and, in addition, the amount of profit. If the selling price of his product does not cover all these items, he will not make a profit; and he may find that, instead of a profit, he actually suffers a financial loss.

The amount that a factor is worth in production depends upon how valuable it is in helping in the process of production. This is a fact that, in general, is well recognized. For example, if a manufacturer needs a worker to operate a highly specialized machine, he may feel that he can afford to pay this operator high wages as compared with what he pays a majority of other

Miners

The income of miners, as well as that of all others who contribute to production, is based upon productivity.

U. S. D. A. Photograph by

workers. But how much can he afford to pay the various kinds of workers in his establishment? The same problem arises in connection with the other two factors of production that the manufacturer must buy.

As you can see, therefore, the amount of money payment that goes to the owner of a factor of production, other than the entrepreneur, is determined by a valuation process. By this we mean that someone in some way places a value upon the services of a unit of a factor of production and that the amount of income which the owner of that factor receives depends upon the estimate that has been made of that value.

Who values the factors of production? In most cases, private employers estimate the value of land, labor, and capital they need and form an idea as to how much a unit of each is worth to them. Of course, they do not wish to pay any more than they have to. But what is the most they can pay?

What Is the Law of Diminishing Returns? Most farmers know that in the cultivation of land there is a point where it becomes less and less profitable to spend effort and money in further cultivation of the same plot of land. While it might pay to spend a week's labor working a plot of ground, it would possibly not be worth while to spend a second week's labor on the same land; and it would probably be even less profitable to spend a third week cultivating it.

Likewise, a factory employer may find it desirable to employ one hundred workers. But he knows that he cannot go on employing additional workers for his factory without adding to his equipment. A point will be reached when additional workers could not add enough to what is produced in the factory to pay their wages.

Thus we see that there is a point where it becomes less and less profitable to employ additional units of land, labor, or capital. Farmers and businessmen may not always recognize this tendency by its technical name, but in the study of economics the tendency, or principle, is called the *law of diminishing returns*. While it is spoken of as a law, it is not the result of the passage of a measure by any lawmaking body. It is merely a tendency that always comes into operation sooner or later when

any one of the factors of production is increased, unless one or both of the other factors are also increased.

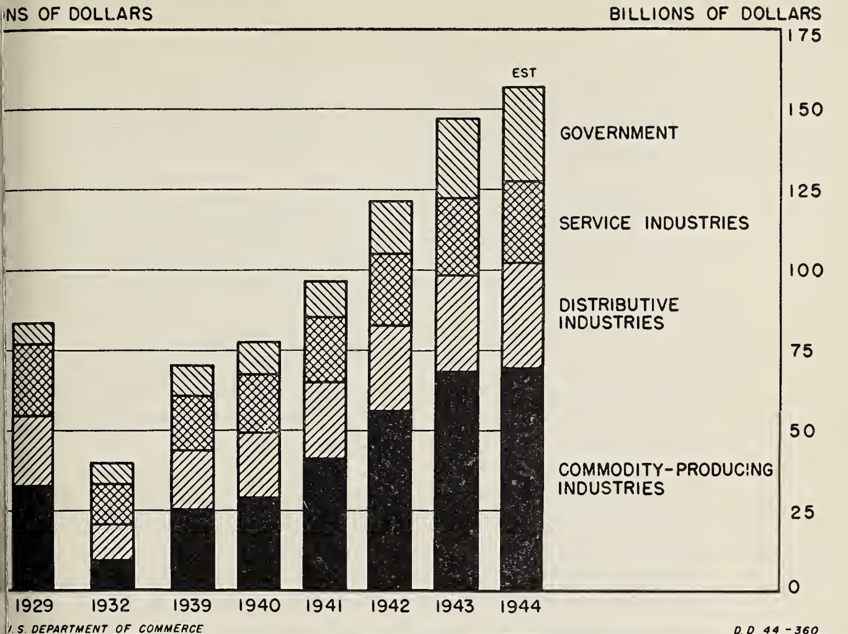
Is Marginal Productivity Important? By *marginal productivity* of a factor of production we mean the amount or value that is added to the total product by the use of a unit of that factor where the units of the factor are all alike. For example, suppose that a brick manufacturer has 100 workers of a particular kind working for him. How much would production be reduced if he had only 99 workers? If he can determine the answer, the number of bricks that would not be produced indicates the marginal productivity of a worker of that kind when 100 workers are employed.

Or let us suppose that a farmer desires to rent some land. He has a certain amount of tools and machinery, enough to cultivate about 50 acres of land. Now assume that he has been able to rent 40 acres and that the owner of an adjoining farm is willing to rent to him another acre. Since he has ample machinery and tools with which to cultivate another acre, you can see that he could afford to pay more for the use of an additional acre than he could if he had 50 acres. On the other hand, if he had the use of 100 acres and owned the same amount of equipment, he would not be willing to pay anything for the use of an additional acre, because another acre would be of no value to him. He could not use it without buying more equipment.

These illustrations help us to understand what is meant by marginal productivity of a unit of a factor of production. Or we may think of the value that would be added to the total product if one more unit of a certain kind were added. For this reason it is sometimes said that marginal productivity is the value of the productivity of one less or one more unit of a factor of production.

In thinking of marginal productivity we must keep in mind that we are thinking of units of factors and that all the units are assumed to be alike. Of course, we know that some land is more fertile than other land; that some workers are better than others; and that a new machine in good condition is better than an old one. But in order to simplify our problem, we may imagine that we are dealing with a factor where the units are all alike.

NATIONAL INCOME BY MAJOR INDUSTRIAL GROUPS



Sources of the Incomes of Individuals by Industrial Groups

In 1932 the money value of the national income was about forty billion dollars. In 1944 it was more than one hundred and fifty billions. As the chart shows, the national income for the years indicated was distributed (1) to those working for the different units of government or as pensions, social security benefits, etc.; (2) to those in service industries, such as public utilities; (3) to those in distributive industries, or trade; and (4) to those engaged in the production of material commodities.

The Proportions of the Factors Affect Marginal Productivity. If a man who wishes to farm has a plow and one horse, he can utilize a certain number of acres to advantage. If he has more equipment, two horses, and a hired man, he can make use of more land. If he did not have enough land of his own for use by himself and the hired man, he could afford to pay rent for additional land. Under these conditions an additional acre of land would have higher marginal productivity than it would have had before.

Likewise, a manufacturer may have space and a labor force sufficient to make use of another machine. He might conclude that another machine would add a great deal to his total out-

put. Under these circumstances an additional unit of capital would have comparatively higher marginal productivity than would another unit of labor.

As you can see, the proportions of the factors of production in an establishment affect the marginal productivity of a unit of any one of the factors. If the supply of labor is large and that of the other factors is small, the marginal productivity of labor is comparatively low. If the supply of capital is large and the supply of the other factors is small, the marginal productivity of capital is low in comparison with that of the other factors. Finally, if the supply of land is large and the supply of the other factors is small, the marginal productivity of land is comparatively small.

Does Marginal Productivity Actually Determine All Incomes? It has been claimed that the marginal productivity of each of the factors of production determines the total income of all the owners of land, capital, and labor. It has also been argued that the marginal productivity of units of land, capital, and labor determines the incomes of individuals.

These arguments, however, are only partly true. Under a condition of perfect competition in the markets for land, labor, and capital, marginal productivity would doubtless determine actual income. The marginal productivity of the workers on different levels would fix the total amount that could be paid; and so with each of the other factors of production. And the competition between entrepreneurs would no doubt tend to cause rents, wages, and interest to approximate the marginal productivity of land, labor, and capital.

But competition in the demand for and the supply of the factors of production is not perfect. And to the extent that it is not perfect, the amounts received in the way of rent, wages, and interest may not correspond to the marginal productivity of one or all of the factors of production. On the other hand, there is usually at least some competition between those who desire to use land, labor, and capital and those who have control of the supply of these factors. Therefore to the extent that competition exists, marginal productivity tends to influence the share of income that goes to the owners of the factors.

But for the purpose of forming a clear idea of the nature and the importance of marginal productivity as it affects rent, wages, and interest, it is helpful to assume that these forms of income arise under competitive conditions. After we have done this, we can examine the conditions other than marginal productivity that influence the distribution of income.

We shall now consider separately the subjects of rent, wages, interest, and profits.

QUESTIONS ON THE CHAPTER

1. What are the shares of the national income?
2. What is meant by the statement, "Money is the power to obtain goods and services"?
3. How does the use of money help in the distribution of the national income?
4. Which one of the factors of production receives the major part of the national income? Does this mean that each one of the owners of this factor has a larger income than each of the owners of the other factors? Explain.
5. If prices in general rise 25 per cent while wages remain the same as before, what fractional part of the former purchases will present wages buy?
6. How are the shares of income for each factor of production affected by demand and supply?
7. Why do we think of productivity as a measure of the income that should be received by each factor of production?
8. Who places a value upon the services of a unit of each factor of production?
9. Illustrate what is meant by the law of diminishing returns?
10. Give an original example to show what is meant by the marginal productivity of a factor of production.
11. What influence does marginal productivity have on the total amount of the national income that goes to each of the factors of production? How does it influence the amount that individuals receive?
12. How do the proportions of the factors of production affect the marginal productivity of any one factor?
13. Does marginal productivity actually determine the income that all individuals receive?
14. What is the meaning of each of the following terms?
    - (a) **distribution**
    - (b) **interest**
    - (c) **law of diminishing returns**
    - (d) **marginal productivity**
    - (e) **national income**
    - (f) **profits**
    - (g) **rent**
    - (h) **wages**

APPLICATIONS OF THE CHAPTER

1. In what ways does the subject of distribution, as the term is used in the chapter, apply to conditions in your community?
2. What have you read recently in newspapers or magazines on the subject of the division of wealth and income in the United States or other countries? Give a report on what you have read.
3. Why do people sometimes say that it is not "right" for a motion-picture actress or a baseball player to receive an enormous salary? What is "right" as concerns the amount anyone should receive in payment for his services? What should be the maximum income allowed an individual? Are those who do not agree with you less intelligent or honest than you are?
4. Aside from the mere fact that they are able to get such incomes, how do you explain why some persons receive $50,000 a year as income while others receive $600 or less? Is the difference in income due to the fact that one group works harder than the other? Is it due to the fact that the services rendered in one case are much more valuable than those rendered in the other?
5. Cite as many examples as you can to show the relation between the amount of income that individuals and families receive and the educational opportunities, the pleasures, the health, the social standing, and the number and kinds of conveniences that people may enjoy. What factors other than income are important?
6. Do you think everyone receives the amount of income to which he is justly entitled? Why? If you think that some receive too little and others too much, what could be done so as to allow everyone to get what he is rightly entitled to? What would be some of the difficulties that your plan would encounter if it were tried out?
7. The assessed valuation of the wealth of the United States in 1940 was $144,631,431,000. If the population in that year was 131,669,000, what was the per capita amount of assessed wealth?
8. Since wealth consists of factories, farms, and other kinds of production goods, what difficulties would be encountered if an attempt were made to divide the national wealth equally among the people? Suppose all the wealth were owned by corporations and that the stock were distributed equally. Would the value of the shares of all persons remain the same? Would the average individual know how to use his right to his wealth intelligently? What do you think would happen to production?

9. (a) Suppose that two men own a small shop in which they make furniture. They do all the work themselves. They admit another partner. What new problems are created as to the division of duties and of income?
   (b) As time goes on, the shop grows and new and larger quarters are necessary. Finally, more than one thousand workers are employed. Show how the method of distributing income changes as the plant grows. What might be the different bases upon which each one connected with the plant would receive an income?

TOPICS FOR SPECIAL REPORTS

1. The per capita amount of the national income and the national wealth of the United States, Great Britain, and other countries.
2. The importance of those things not counted as wealth.
3. Why the subject of the distribution of wealth and income is of importance to every one.
4. Why not everyone is entitled to the same amount of income.
5. How all income and wealth are produced by co-operation.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is a man entitled to all he can make in the way of wages, rent, interest, or profits?
2. Should anyone be allowed to inherit a fortune large enough to enable him to live without working?
3. Will people work as hard for other things as they will for money?
4. Are practically all social and political problems related to the distribution of income?

CHAPTER 22

RENT FOR LAND

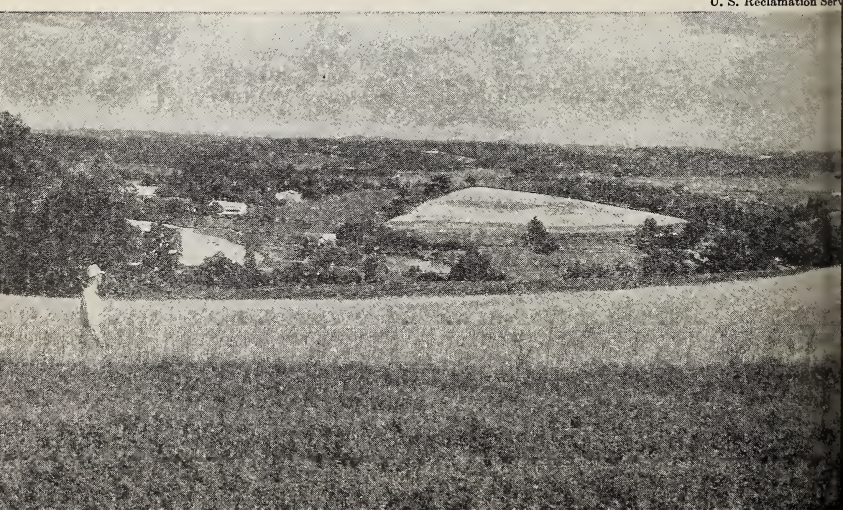
In this and the three following chapters we shall find out more about how the incomes of the owners of the four factors of production are determined. In this chapter we shall consider that part of the incomes of landowners that is received because their land is used in production.

What Is Rent? At one time or another you probably have rented some articles, such as a book from a library. And no doubt you have heard people speak of renting a house, a piece of land, an automobile, or a piece of equipment of some kind. What is implied in each of these cases is that the one who rents the article obtains the use of a comparatively durable good and agrees to pay a price for its use for a given period of time. At the end of that time, the good is to be returned to the owner. Thus we see that the term "rent" is used to indicate the payment for the use of a variety of goods of a durable nature.

The Land

In the final analysis, land is the source of our living and all material wealth.

U. S. Reclamation Serv



As we shall use the term "rent" in this chapter, however, it refers to the income that is received by the owner of land for the use of his land in production. By land, as we have learned, we mean natural resources, including the soil, the minerals, and the other materials that make up the earth; the water and the natural products of the soil, as well as climatic conditions. There is no objection, either, to including in the term all the improvements and the changes that have been made in the land which are of a practically permanent nature.

Commercial Rent of Land. When one rents a farm, a lot, or a building that is located on a lot, he pays a price for its use. This amount is *commercial* or *contract rent.*

Economic Rent of Land. Economic rent is the income earned by the owner of a given piece of land because the land is used for productive purposes over a given period of time. At first you may be inclined to think that there is little or no difference between commercial rent and economic rent. But the two terms are different, and it is very important that we make distinctions between their meanings.

When one agrees to pay commercial rent, there is no doubt as to the amount of rent. We can tell exactly how much the owner of the land receives from the tenant. But suppose the owner uses the land himself. Does he receive any income because of the use of his land? The answer is that he does receive an income, provided he gets back more than he puts into the utilization of the land. That is to say, if the value of the product from the land is more than the cost of the capital and of the labor and the profit he would make if he paid rent to someone else for the land he uses, he receives an income because of the use of the land. The amount of this income is known as economic rent.

It is because of the estimated productiveness of a piece of land that a tenant is willing to pay for its use. But economic rent comes into existence whether the owner allows someone else to use his land and receives payment for it, or he uses it himself. For this reason it is sometimes said that economic rent is that part of the income that may be imputed to the use of land.

What Is Meant by the Demand for Land? The most obvious function of land is that it provides "standing room." In spite of the fact that man has learned to fly, and to dive under the surface of the water in submersible ships, we are still pretty closely tied to the surface of the earth. Most of us stand or move over the surface of the earth most of the time. And, in addition, our houses, factories, highways, railroads, playgrounds, and other structures are located on sites provided by the land.

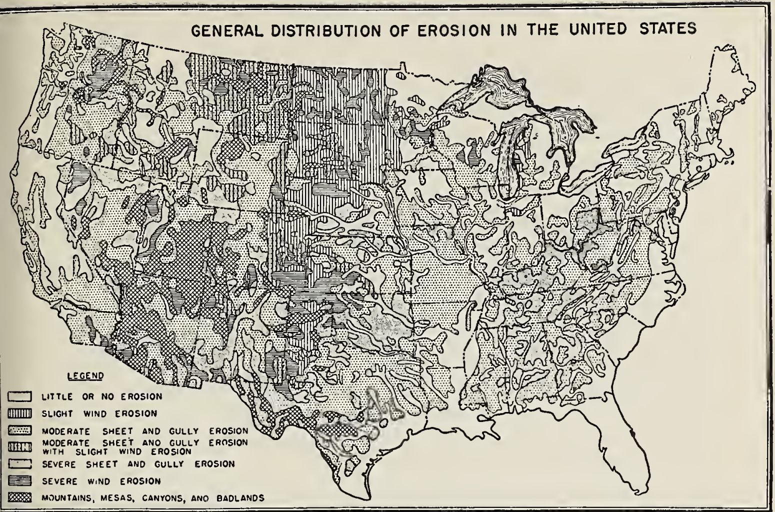
As a factor in production, land contributes all the original material things that are used in the production of goods. Although man creates greater utility in the materials supplied by nature when he changes the form of the materials into goods, he is still dependent upon the storehouse of nature for the materials he uses.

Therefore the demand for land arises from the fact that it furnishes standing room and that the resources of nature are capable of being used in various ways to satisfy our wants. In some cases land can be used directly to meet our needs, as in the case of playgrounds and natural parks. In other cases it can be used indirectly, as when we take ores and convert them into different kinds of goods.

Land in residential districts is not wanted for the production of goods. Therefore the demand for land in residential districts, particularly where separate residences are the rule, arises largely because of the utility of the land for consumer uses. The user, whether a tenant or an owner, wants the land because it possesses certain qualities that are desirable for residential purposes.

Land that is wanted for the growth of agricultural crops, the erection of factories, the cutting of lumber, or the erection of stores and other kinds of business structures is wanted for productive purposes.

All Land Is Not Equally Productive. Of course you know that land is not all alike. In agricultural districts some acres will yield much larger crops than others. In various regions of the country we find that some areas are suited to the production of wheat, corn, cotton, and so on. And some areas seem unsuited to any use, not even to parks.



U. S. Department of Agriculture

Erosion and Productivity

Both erosion and unwise cultivation may result in land becoming marginal or submarginal.

Much of the agricultural land in the United States is not very productive because its original fertility has disappeared. In many places erosion from wind and rains have stripped away the soil. In other places, growing the same kind of crop year after year has depleted the food elements of the soil.

When we think of the different locations and sections of a city with which we are familiar, we realize that urban land also is not all alike. Because of business and industrial developments, some parts of a city are more desirable for one purpose than are others. There are one or more districts that, because of the presence of similar kinds of business establishments or other reasons, are more desirable as locations for certain kinds of businesses. For example, if a person were looking for a location for a clothing store, he would hardly wish to buy or rent a site in a section given over to manufacturing. Neither would he think of establishing a factory in the financial center of a city.

Then, too, there is great variety in the desirability of the particular locations within given areas in a city. The number of people who ordinarily pass along the sidewalk or the street,

the ability of the people to buy what one might wish to sell, why they pass along and where they are going, whether the sun shines on the front entrance, and other factors often influence the value of any business location.

Physical Qualities and Location Affect the Value of Land. The value of land depends largely upon its fertility or other productive qualities and upon its location. In the case of agricultural and mineral land, the qualities of fertility or the richness of mineral resources are usually the most important considerations. Of course, location, even in the case of agricultural and mineral lands, is a factor that has its influence. For example, if two farms have equally fertile soil, the one that is more conveniently located for the marketing of products is the more valuable.

An Abandoned Farm

The land failed to produce enough rent to justify its continued use.

Bureau of Reclama

The value of urban land, as a rule, does not depend upon the qualities of the soil or the nature of mineral resources. The reason for this is that land in the business and industrial sections of a city is wanted as locations for business and industrial enterprises, such as stores, banks, theaters, hotels, and factories. Therefore in urban areas the most important factor relating to the productiveness of a piece of land is its location.

Rent Results from Differences in Productivity. In order to illustrate how rent arises because of differences in the natural productiveness of the soil of land, let us take an assumed case from agriculture. Let us say that there are three farmers—Jones, Brown, and Bruner—and that each owns fields of equal size, but of different fertility. Let us say also that they are equally efficient and that if each spent $1,000 for planting, cultivating, harvesting, and for the use of machinery and seed, the number of bushels of wheat produced would be as follows: Jones, 1,800 bushels; Brown, 1,300 bushels; and Bruner, 1,000 bushels. If we assume that wheat is selling at $1 a bushel, the results would be as follows:

	JONES	BROWN	BRUNER
Amount received from the sale of his crop	$1,800	$1,300	$1,000
Expense of producing his crop	1,000	1,000	1,000
Difference or economic rent	$ 800	$ 300	$ 0

Under the conditions assumed above, the economic rent of Jones's land would be $800, and that of Brown's, $300. Bruner's land would yield no rent. As the economists say, Bruner's land is *marginal* or *no-rent land.* That is to say, it is just on the margin or line between land that yields a rent and land that can be used only at a loss. The rent of all land—agricultural or urban—that is used for particular purposes is measured from the marginal land that is being utilized for the same purpose.

You may ask, Why does Bruner use his land, if he gets no rent from it? The reason is that under free enterprise, where there are many producers, land of varying productiveness is used. There is not enough of the best land for everyone who wishes to farm or to use it for other purposes. Consequently

A Bountiful Crop of Potatoes

Returns to the operators of productive land may be high.

Bureau of Reclamation

some of those who are unable to obtain the use of the best land make use of inferior land. Since people are free to buy or rent land, there are those who are willing to make use of the poorer parcels. They are willing to take a chance of being able to get back more than they put into the expense of operating their farms. Or it may be that those who are operating the poorer land had reasonable expectations of obtaining rent, but that a fall in the market price of farm crops caused the land to become marginal or no-rent land.

As you can see, the economic rent of land is affected by the quantity of the product of the land; and the money value of the rent depends upon the market price of the product. In the above example, if the price of wheat increased to $1.50 a bushel, Bruner's wheat would sell for $1,500 and his land would yield $500 in rent. Likewise, Brown's rent would be increased to $950, and that of Jones, to $1,700.

In the above illustration we have chosen an assumed case of the utilization of farm land. If you will assume a case of three business locations in a city where equal expenditures will yield the returns used in the illustration of farm land, you can see the urban rent may arise from differences in the productiveness due to the location of different lots of land. In all cases, of course, we must take it for granted that all of the operators of land are equally efficient.

Where the difference in the yield of two or more parcels of land is due only to differences in fertility or location, rent is measured from the land the product of which is just equal to the cost of production.

Rent Is Affected by the Intensity of the Use of Land. Now let us see how the operation of the law of diminishing returns may bring about rent even where land is all equally good. Suppose that Mr. Ray has two units of labor and capital of $200 each, making a total of $400 of labor and capital, that he wishes to spend on the cultivation of land. Let us say that he owns a parcel of land and that his neighbor owns a similar parcel of equally productive land which he would allow Mr. Ray to use if Mr. Ray would pay him something for its use.

Let us say, also, that if Mr. Ray should spend $200 in the use of his land, he would get 400 bushels of wheat, which at $1 a bushel would be worth $400; and that if he should spend $400 on his land, he would get 750 bushels, worth $750.

Now, since Mr. Mason's land is just as productive as Mr. Ray's, you can see that if Mr. Ray should spend $200 on his own land and $200 on Mr. Mason's land, he would get 800 bushels of wheat, worth $800, or $50 more than if he spent the entire $400 on his own land. Therefore he could afford to pay Mr. Mason something for the use of his land.

Where people are free to engage in agriculture and other kinds of industry and business, it is likely that there are some who continue to use capital and labor in the utilization of land even after the law of diminishing returns sets in. That is, some continue to add units of labor and capital until the value of the returns from the land is only equal to the cost of producing the product. This is the point of the intensive margin.

The *intensive margin* is the point where it is no longer worth while to add a unit of capital and labor in the utilization of land. But we speak of the intensive margin only when land is used after the law of diminishing returns sets in. The intensive margin means the point of "no rent." And the amount of rent is measured from this zero point.

Land Is Used Extensively and Intensively. The above discussion explains how rent can arise from either or both of two

causes. It can arise from differences in what we may call the natural productivity of land. Therefore it would come into existence wherever two pieces of land of unequal productivity were used for the same purpose. For example, if one acre of land will produce 25 bushels of wheat with an expenditure of $10 in labor and capital, while another acre will produce only $10 worth of wheat, the first acre produces rent to the value of $15 if wheat sells at $1 a bushel.

But if all land were equally productive and if some of it were used beyond the point where the law of diminishing returns sets in, it would be more worth while to use other parcels of land less intensively, which would produce more rent.

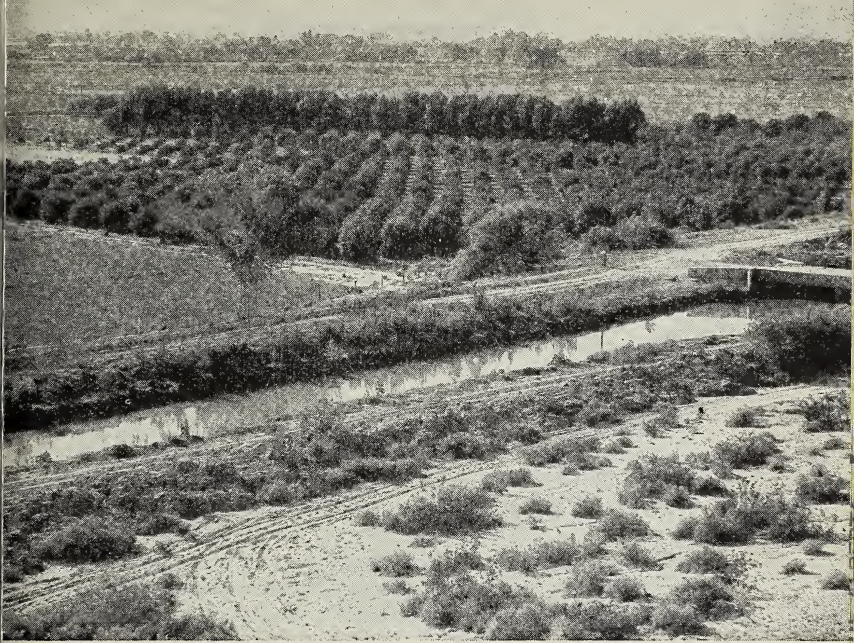
In actual practice in the world of business and industry, both the differences in the productivity of land and the operation of the law of diminishing returns work together to produce rent.

The Supply of Land Is Limited. Land is always wanted for some particular purpose. For example, if one wants to grow oranges, he must go to Florida or California or some other place where the soil and the climate are suitable. And land in these regions is not unlimited. Or if he wants to open a store in the very best business district in a town or a city, he will find that the number of the better sites is also limited.

It is evident that we cannot do much about increasing the amount of land. In some places small areas have been reclaimed from the waters, as is the case in Holland. And irrigation has made some additional land available for cultivation. Perhaps the improvements in methods of transportation have done more than anything else to make more land available for use.

With respect to supply, land is different from most other kinds of goods. There may be but one best business location in a city. But if a certain manufacturer builds one "best" car, he can build many others exactly like it and thus increase the supply indefinitely.

How Do Demand and Supply Determine Commercial Rent? Like the prices of commodities, the prices that owners of land receive for the use of their lands are fixed by the demand for and the available supply of land that may be used for particular



Bureau of Reclamation

Irrigation

Irrigation increases the supply of land that can be used profitably. Note the contrast between the sagebrush in the foreground and the irrigated land on the other side of the canal.

purposes. As a rule, the amount of commercial rent that a tenant agrees to pay is fixed by agreement. Both the owner and the prospective tenant form their opinions as to the productivity of a given piece of land. The owner endeavors to obtain as high a rental price as he can; and the prospective tenant tries to obtain the use of the land for as low a price as possible.

"The Farm Problem" Is Related to Rent. For many years before World War II there was a great deal of talk about "the farm problem." And we shall probably continue to hear about it. Let us see what "the farm problem" is, how it came about, and what has been done to solve it.

The Effects of World War I on Agriculture. Prior to World War I, particularly from about 1910 to 1914, American agriculture was comparatively prosperous in comparison with other industries. And when the war came, prices of farm products

increased greatly. For a few years there was a great demand in Europe for our food supplies, and farmers redoubled their efforts to increase production. More farm land was brought into cultivation, and the adoption of improved farm machinery resulted in the production of more products per worker than before.

When the war ended, and Europe was again able to produce most of her own food supplies, our exports of farm commodities declined rapidly and prices fell. It was extremely difficult for farmers to curtail production. Most of them had no other way of making a living. Of course, if they could have reduced production in proportion to the decrease in the demand for farm commodities, prices of the things they had to sell would not have fallen. But there were between six and seven million farmers with no other way of making a living. Therefore there seemed to be little they could do except to go on farming.

The discontent of the farmers became so great that in 1929 the Federal Farm Board was established under the Agricultural Marketing Act. The Board encouraged the co-operative marketing of farm products, but its efforts in this connection had little effect in raising prices. Then in 1930 the Board tried to raise and stabilize the price of wheat at 70 cents a bushel. The idea was to create an increased demand for wheat by means of purchases by the Government. A similar program for the purchase of cotton was undertaken. But in spite of these efforts the prices of wheat and cotton continued to decline.

In 1933 the *Agricultural Adjustment Act* was passed. The principal aim of this law was to raise and control farm prices. Under the law, if farmers would agree to reduce production of such crops as cotton, wheat, and tobacco, the Government would pay them certain amounts, or "benefits," in money. Funds to carry out the program were to be raised by means of taxes on manufactured farm products. During the two succeeding years, the prices of farm products increased somewhat. But in 1936 the law was declared unconstitutional by the United States Supreme Court.

Shortly after the law was declared unconstitutional, Congress passed the Soil Conservation and Domestic Allotment Act, which was supplemented in 1938 by the second Agricultural

Adjustment Act. The main features of these laws were: (1) to raise the prices of farm commodities; (2) to encourage farmers to conserve and restore worn-out and depleted soils; and (3) to grant subsidies to farmers who would co-operate with the Government in its farm program.

Farmers who would agree to devote a part of their farms to the growth of soil-building crops, such as clover and other leguminous crops, and thus reduce the production of crops grown for market, were to receive benefit payments. Such farmers would also receive *parity payments*. The object of parity payments was to give to farmers who produced wheat, cotton, corn, rice, and tobacco, amounts of money, which, when added to incomes from the sale of such products, would give farmers purchasing power that would enable them to buy as many manufactured goods as they could have bought from the sale of the same amount of products during the period from 1910 to 1914. And, in addition, the laws also provided that farmers could store their crops and pledge them as security for loans from the Government. Then, when and if the prices of the products should rise, the farmers could sell the crops and repay their loans from the Government.

The Effects of World War II on Agriculture. When World War II came, the prices of farm commodities again soared. Production of farm commodities increased, and the value of farm land rose. Much land that formerly had been marginal now produced crops the sales of which yielded rents to the owners.

Thus we see that fundamentally the farm problem is closely related to the rent of land. When market prices rise, marginal land often becomes valuable, because the income from the sale of crops more than covers production costs. And when prices fall, much of the land becomes marginal.

What is the future of the farm problem? The answer will depend upon conditions of demand and supply. It is possible for American farmers to produce a great deal more than they can sell to the American consumers alone at prices that will enable the farmers to live well. On the other hand, if farmers can find a market in foreign countries for their products, there

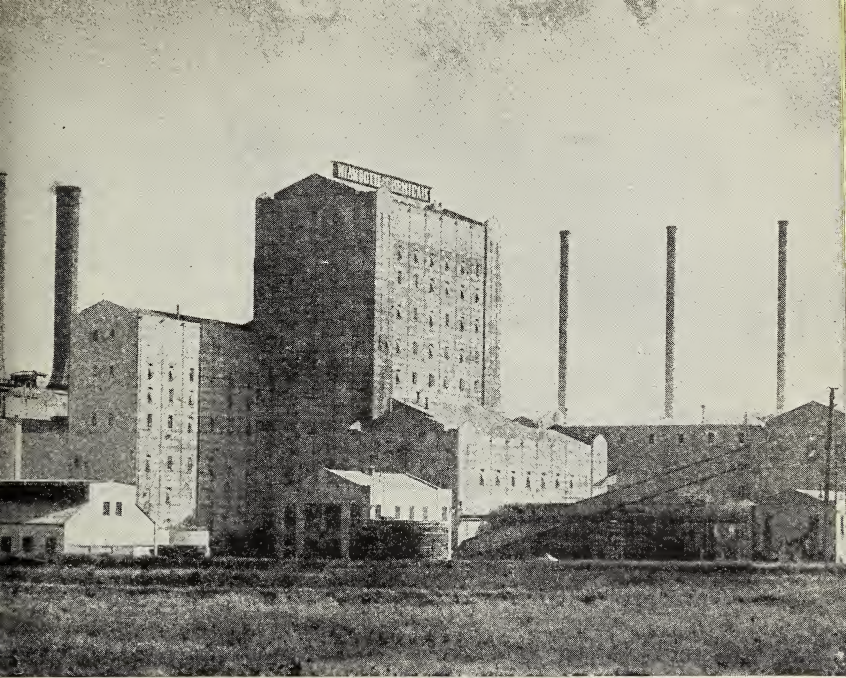
may be a demand at good prices for their products. But here again is a problem: Can American farmers compete in foreign markets with other farmers in different parts of the world? Will farmers in other countries be able to sell at lower prices than our farmers will be willing to take for their products? These are questions that you will probably hear discussed in the future.

Do Landowners Earn Rent? As population increases, the amount of available land decreases in proportion to the number who need land. And as population increases, the rent of land tends to rise. Because of these facts it has been claimed by some that the value of land, which arises because of differences in economic rent, is an *unearned increment* of value; that is, those who receive commercial rent as a form of private income do not earn it. Those who take this position maintain that the owners did not create the land; and the amount of income in the form of rent that the owners receive is the result of an increase in population. Moreover, they say, any profit made by owners who sell land for more than they paid for it receive a benefit that they did not earn.

From earliest times there have been people who have argued that it is not right for private individuals to receive rent from land. But it was Henry George, in his book *Progress and Poverty* published in 1879, who popularized the idea at that time of taking away the rent of land by means of a single tax. His idea was that the private ownership of land is the underlying cause of poverty. He argued that those who own land can compel others to work for them and to pay them incomes to which they are not entitled.

Henry George contended that all income from land ownership should be taxed 100 per cent. He maintained that if this were done, the income to government would be sufficient to defray all the expenses of government, which would make it possible to do away with all other kinds of taxes. Hence the proposal is often referred to as the *single-tax proposal.*

The single-tax argument carries little weight with most people today. At the same time, the single-tax movement has had some important effects. For one thing, it called attention to the political and social power that ownership of land gives



Wyandotte Chemical Co.

A Chemical Factory

Factories are usually located in the low-rent districts of a community. Do those who own this land earn the rent they receive?

the owners of a great deal of valuable land. For another thing, discussions of the single-tax proposal have helped to cause students of taxation to study real-estate taxes more carefully. It is now more generally recognized that the value of land depends upon the economic rent of the land. And since this is true, commercial rents depend to a considerable extent upon the economic rent of the land. Therefore, whether the owner uses his land himself or rents it to another, his income from his land depends upon economic rent.

Now one's ability to pay taxes really can be measured best by the amount of his income. Therefore the amount of the tax on land should be at least somewhat in proportion to the economic rent of the land. In many cases authorities who appraise land for the purpose of levying taxes now try to base their estimates upon the value of different plots of land when used for productive purposes.

QUESTIONS ON THE CHAPTER

1. Explain what is meant by "the term 'rent' is used to indicate the payment for the use of a variety of goods of a durable nature." Give illustrations.
2. Does the amount of commercial rent tend to equal the amount of economic rent?
3. What is meant by "the demand for land"?
4. Distinguish between the utility and the productiveness of land.
5. Why does the productiveness of land vary?
6. How do fertility and location affect the value of land?
7. Explain how rent is based upon differences in productivity.
8. Does intensive use affect the productiveness of land? If so, in what way?
9. Explain how rent may be measured from the intensive margin.
10. Under most actual conditions are differences in fertility and location and intensiveness of use factors that cause rent?
11. Why is it said that "the supply of land is limited"?
12. Explain how both the demand for and the supply of land help to determine rent.
13. Explain how rent is related to "the farm problem."
14. What is the meaning of each of the following terms?

    (a) **Agricultural Adjustment Act**
    (b) **commercial rent**
    (c) **contract rent**
    (d) **economic rent**
    (e) **intensive margin**
    (f) **marginal land**
    (g) **no-rent land**
    (h) **parity payments**
    (i) **single-tax proposal**
    (j) **unearned increment**

APPLICATIONS OF THE CHAPTER

1. Discuss several local examples and problems pertaining to rent.
2. Discuss a current newspaper item or magazine article dealing with rent.
3. Not many years ago crops occupied the land in that part of New York City where skyscrapers now stand. Explain how rent caused the change in the use of the land.
4. Explain how rent causes high buildings to be constructed in large cities.
5. The United States Government has proposed to move farmers from marginal farm lands to more productive land and to place some of them in other occupations. Discuss the undertaking.

   Must there always be marginal land? Is the Government under an obligation to help, in the manner suggested, the

farmers who live on poor land? Can the farmers help themselves? How? How has the increase in the number of farmers and in the use of machinery on farms caused much farm land to become marginal?

6. Explain the relation between rent and the right to own private property.
7. Show how rent has produced city slums as well as palatial apartment houses.
8. Discuss proposals by the Government to remove slums. In what way is rent involved in the proposals?
9. Do you know of an instance in which the value of land has increased partly or largely because of an increase in the population in the vicinity of the land? Is the owner entitled to the increase in the rent that the land will command? Would it be desirable for the Government to appropriate (to take by taxation) the amount of the increased rent? Was the land bought as an investment? If it would be right for the Government to appropriate the rent from the land, why would it not be right for it to appropriate other kinds of income? In what ways is land different from other factors of production?
10. Suppose you wished to find a location for a store. What factors would you consider? Would these factors be different from those you would consider if you were locating a factory? Why or why not?
11. Do people pay rent because they have to pay for the use of land or because they can afford to pay for it? How does your answer help to explain the relation between rent and the prices of goods?
12. If all land were equally fertile and equally well situated, would there be rent? Why?
13. Explain how an increase in the price of cotton or wheat causes an increase in the rent for land.
14. How do laws that restrict or limit the use of land affect the value of the land? For example, suppose that you owned a lot in a certain section of the city and a zoning law making it impossible to erect a building on the lot at a cost of less than $20,000 was passed. Or suppose that the law prohibited the erection of a gasoline filling station or a store of any kind on the land. Discuss the various aspects and possibilities of the problem.
15. Can you see any relation between rent and improvements in the methods and means of production? For example, do you see any relation between the increase in the amount of rent from western farm land and the use of the McCormick reaper? What factors other than improvements in the methods of production may cause rent to increase?

TOPICS FOR SPECIAL REPORTS

1. The relation of rent to the prices of farm products and of manufactured products.
2. The quantity and the importance of marginal land in the United States.
3. Ricardo's ideas concerning rent.
4. The influence of rent on the western migration of the people in the United States.
5. The importance of fertility and of location as causes of rent
6. Henry George.
7. The single tax.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should the single tax be adopted?
2. Should the uses to which land may be put be determined by the Government?
3. Is an increase in population the most important factor in the increase of land values?
4. Should the Government lend money to tenant farmers on long-time terms in order that they may buy farms for themselves?

CHAPTER 23

WAGES FOR LABOR

Wage payments is a subject of great importance. In the first place, a great majority of workers are dependent on wages for all, or nearly all, of their incomes. In the second place, there are great variations in the amount of wages that individuals receive. As a rule, skilled workers receive more than the unskilled. But there are great differences in the incomes that skilled workers receive for their services. A few corporation heads draw incomes from their corporations amounting to several hundreds of thousands of dollars a year. At the same time, certain professional workers, including teachers, nurses, and social workers, receive from a few hundred to not more than several thousands of dollars a year.

What determines the wages that individuals receive? This is a question in which nearly everyone is interested. Let us see if we can find the answer.

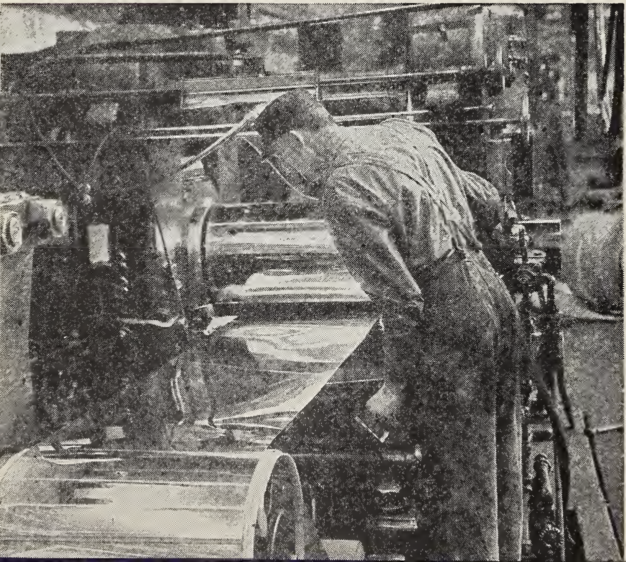
The Term "Wages" Is Used in Several Ways. As we shall use the term, *wages* refers to any kind of remuneration for human services in production. That is to say, fees, commissions, and salaries, as well as other payments per period of time or per piece of work, are all forms of wages.

Economic wages, or *implicit wages* as they are sometimes called, consist of that part of production that may be attributed to labor, whether the individual works for himself or someone else. A *contractual*, or *money, wage* is the amount of money that a worker receives for his services during a given period of time. *Wage rates* are the amounts of money that are paid per period of time, as $5 a day, or 75 cents an hour, or $2,400 a year. Or they may refer to the price per piece of work the employer agrees to pay, as when a miner is paid 80 cents or $1 a ton for the coal he mines.

Do Demand and Supply Fix Wages? Broadly speaking, the demand for and the supply of labor determine wages. But when we have given this answer, we have merely indicated the general factors that account for wages. In order to understand the answer, we must learn more about the nature of the demand for and the supply of labor.

What Is Meant by the "Demand for Labor"? Employers in industry and business hire workers because they need certain kinds of human services. The textile manufacturer needs employees to tend spinning machines and weaving machines; the automobile manufacturer needs workers to use certain tools, run machines, or help assemble cars; and the manager of a store needs persons to sell goods and to perform other selling services.

It is sometimes said that the demand for labor is a *derived demand*; that is, the demand for labor derives or comes about because there is a demand for the things that labor can produce. And it is true that in industry and business the demand for labor depends largely upon the demand for goods. When the demand for goods is great, there is a tendency for employers to hire more workers; and when the demand for goods decreases, fewer workers are hired and frequently some that had been employed are discharged.



Cold Rolling Mirror-finish Strip Steel

This workman is highly skilled and receives good wages. The demand for his skill is derived from the demand for the products he helps to make.

American Steel & Wire Co.

We should also note that the demand for labor is specific. Workers are employed to do certain kinds of work. A manufacturer does not just hire a worker: he hires a man to run a lathe, to keep the stock room, or to do some particular kind of work. We also sometimes speak of the general demand for labor, as when someone says there is an increase in the general demand for labor. All this expression means, however, is that there has been an increase in the specific demand for a great many different kinds of workers.

The Productivity of Workers Limits Maximum Wages. On the whole, that part of the national income that goes to workers must first be produced by the workers themselves. And wages that are paid workers by employers must be earned; that is, the labor for which wages are paid must add enough to the selling price of a product to pay the wages of the workers. That is what we mean by saying that employees must earn their wages before they can expect to be paid.

Under a condition of free competition, the amount of wages paid for labor tends to equal the marginal productivity of the workers. In order to explain what this means, let us assume an illustration from a manufacturing establishment.

As we know, it is the purpose of the manufacturer to take various kinds of materials and by the use of labor and capital to turn the materials into units of finished goods. Since he uses materials that came from the land, and since the factory occupies land, we can see that the manufacturer employs three factors of production—labor, capital, and land. His aim is to use all these factors to produce a product that he expects to sell—at a profit. Naturally he does not wish to pay more for a unit of a factor of production than he has to, at least not more than the unit of the factor is worth.

Now in order to get an idea of how much of the total product of the factory may be attributed to labor, let us suppose that the manufacturer begins with a considerable amount of land and capital. To simplify our problem, let us say that the workers he employs are alike in ability, and that he adds one at a time to his labor force. At first the percentage of increase in total production will likely be very great. For example, if


U. S. Department of Agricul
Loading Peanuts Into a Truck

Physical strength is the most important requirement for work of this kind, and little training is required. As a result, wages are low.

he increases the number of workers by 10 per cent, the amount of the total product would increase by more than 10 per cent.

But the manufacturer cannot go on indefinitely increasing the number of workers. A point will be reached where the increase in total production from the addition of another worker will be proportionately less than was the increase from the addition of the last worker. As we know, the proportional decrease in the product of workers, as additional workers are employed, is due to the operation of the law of diminishing returns, or *the law of diminishing productivity* as it is usually referred to when it applies to labor.

After the law of diminishing productivity begins to work, the product of each additional worker hired will continue to decrease proportionately as the number of workers increases. Finally a point will be reached where the value of the product will equal only the value of the wages of the worker. When

this point has been reached, the employer will not hire an additional worker. Of course, the manufacturer might be able to hire more workers if he increased the amounts of land and capital he uses. But we are assuming that he does not enlarge his factory.

Does Marginal Productivity Fix the Wages of the Group? Under competition, the wage of the last worker hired—which tends to equal the *marginal productivity* of the workers—tends also to fix the wages for the group where all the workers have about the same ability. The reason for this is that each worker will demand as much as the others are getting. Since, as we assume, all workers are alike in ability, no one worker can say that he is worth more than another. Therefore the employer pays the same amount of wages to all the workers of the same kind and of similar ability. And the amount paid is usually less where there are many employees of a given kind than when there are fewer. The reason that it is less is that, after the law of diminishing productivity comes into operation, the productivity of a worker is smaller when there are many than when there are not so many.

What Is Meant by the "Supply of Labor"? You will recall that we said that labor is wanted for specific purposes. Therefore when we speak of the supply of labor, we refer to those workers who are able and willing to render certain services at certain prices or wages. Therefore, the supply of labor varies with wages. If there is an increase in the wages for one kind of work while the wages for other kinds of work do not change, the number of those who will apply for the first kind of work will increase also. Likewise a decrease in wages will result in a decrease in the number of those who will apply for work, provided, of course, there are other opportunities for employment.

Why, then, do not changes in wages result in an equal supply of labor for all kinds of work? In the first place, there are some kinds of work that require exceptional talent, which the majority of workers do not possess. In the second place, there are frequently rules and laws that prevent the employment of those persons who do not give evidence of a sufficient

degree of skill or who have not otherwise met the established requirements. For example, there are relatively few people who have the superior talents and physical qualifications that movie stars possess, although there is no law against "going into pictures" if one can pass the screen tests. In some of the professions, there are certain requirements that, under the law, must be met before one can practice the profession.

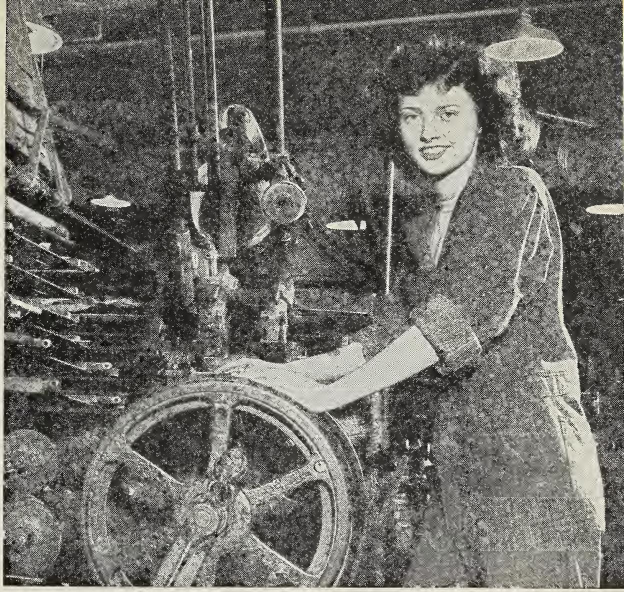
What Are the Characteristics of Labor? Labor possesses certain characteristics that we should understand when considering problems relating to the supply of labor.

(1) *Labor Is Perishable.* Although the employer must look upon the cost of labor much as he does upon the cost of raw materials, labor is different from materials. It is absolutely perishable. It cannot be stored. A day lost by a worker can never be regained.

This characteristic of the labor supply is important for two reasons. In the first place, the worker is at a disadvantage in trying to bargain with an employer. He cannot hold out for higher wages without losing forever a part of the labor that he has to sell. In the second place, lost labor results in the production of a smaller amount of goods and services than might be produced if all labor were utilized. This fact is of importance to all consumers of goods and services.

(2) *Labor Cannot Be Separated from the Person.* Unlike goods, labor is always associated with a person. When an individual sells his labor, something more than the labor is involved. For example, the worker must consider working conditions when he offers to sell a day's services. To work a day for $5 in a poorly ventilated, evil-smelling factory is quite different from working for the same amount of money in a well-lighted and well-ventilated factory.

(3) *The Supply of Labor Does Not Change Quickly.* From fifteen to twenty-five years are required for an increase in the total labor supply to take place. And, except in the case of war or some other catastrophe, a longer period of time is required for a decrease to occur in the supply. Of course, we must keep in mind that what is meant here is the total labor supply.



A Woman Tire-builder

The use of machinery simplifies many tasks and makes work lighter so that women can be employed.

B. F. Goodrich Co.

(4) *Most Workers Do Not Like to Move.* The extent to which labor moves from one market to another depends upon the willingness of the workers to move from one locality to another. Goods, like wheat, cotton, or shoes, can, on the other hand, be shipped anywhere. As a rule, however, individuals do not like to move, even when they feel that they could obtain higher wages elsewhere. Family, friends, religion, customs, and community ties tend to keep the worker anchored to one place.

If people are loath to move from one place to another in the same country, they hesitate even more to go from one country to another. For this reason and also because of immigration restrictions, it is possible for wages to be much lower in one country than in another without causing any marked movement of labor from the one country to the other.

Do Standards of Living Affect the Labor Supply? We shall be able to avoid confusion and misunderstanding if we make clear what we mean by the expression "standard of living." Therefore, let us say that by *standard of living* we mean the way that people would like to live, and by *scale of living* we mean the way that they actually live.

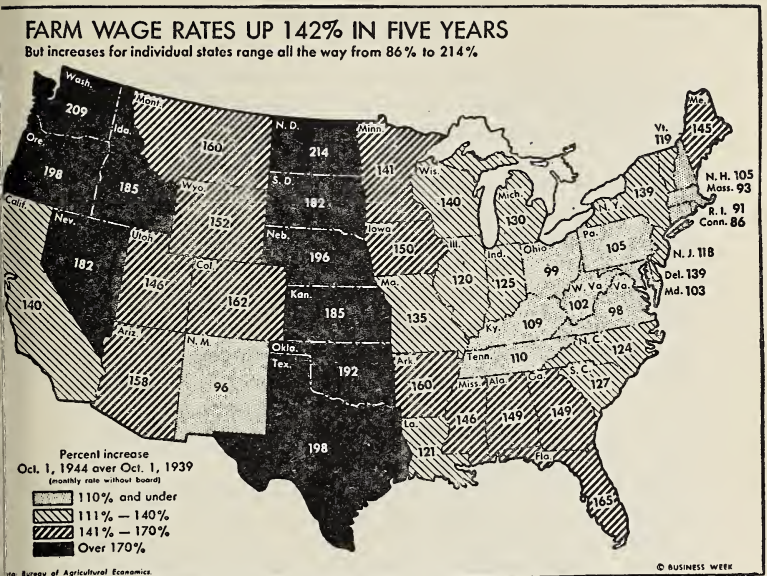
In some cases it is possible that if one has a high standard of living, he will be able to strive for and obtain high wages.

For example, he may join a labor union and by co-operative action with others, he may be able to bring pressure to bear on the employer through force of numbers and thereby get an increase in wages or resist a cut in wages. The influence of a high standard of living on wages, however, shows itself in two other ways.

If one is not content with a low scale of living, he may strive to improve his knowledge and skill, so that he becomes more productive. When he succeeds in doing this, his productivity increases, which is likely to make him more valuable to an employer. As a result, he may be able to obtain higher wages.

In the long run—that is, over a period of a generation or more—standards of living affect the total labor supply, as well as the supply of labor of particular kinds. Although the rule has exceptions, it is noticeable that the lower the standards of living, the earlier people get married and the larger are the families. On the other hand, individuals with higher standards of living usually postpone marriage until they have reasonable assurance that they can support children and give them educational and other advantages. Consequently, as the standard of living increases, there is a tendency for population to increase more slowly than before. Meanwhile the amount of capital and laborsaving machinery increases, which enables workers to produce more per worker than before. In other words, because of the increase in laborsaving machinery and because the number of workers is smaller in relation to capital, the marginal productivity of workers increases, which results in higher wages.

Effects of Income on Standards of Living. At this point we might well raise the question, Does not the amount of one's income help to determine his standard of living? The answer is that it does. As one's income increases, the more goods he is likely to buy. He is also likely to insist upon a better quality of goods. And as he becomes accustomed to more and better goods, he becomes more concerned that his income will continue to be sufficient to enable him to have the things to which he has become accustomed.



Increase in Farm Wage Rates, 1939–1944

Do these increases in wage rates for a wartime period necessarily mean that those who received farm income had higher standards of living?

For this reason personal income and standards of living often react upon each other. Sometimes a rise in his scale of living will cause a worker to seek an increase in wages by increasing his marginal productivity. On the other hand, an increase in his standard of living may result from a rise in a worker's scale of living.

The Malthusian Theory of Population. About a century and a half ago an Englishman, Thomas Malthus, wrote a famous book on the subject of population and wages. It contained the conclusions of Malthus as to the relation between wages and the population of a nation. These conclusions are sometimes called the *Malthusian Theory of Population.*

It was his idea that population, and hence the number of workers, tends to increase much faster than does the food supply. In fact, he asserted that the population tends to increase at a geometrical ratio, while the means of subsistence tends to

increase at an arithmetical ratio. In other words, he thought the rate of the increase of people is 1, 2, 4, 8, 16, and so on, while the food supply increases at the rate of 1, 2, 3, 4, 5, and so on.

Malthus recognized that this rate of increase in population might be hindered in two ways: (1) wars and pestilence might kill off large numbers; (2) the size of families might be controlled. At the time, however, he was inclined to take a pessimistic view. He felt that, if the means of getting a living became easier, the population would increase to the point where the working people would barely find it possible to live. The views of Malthus led to the *subsistence theory of wages.* According to this theory it is held that wages sufficient to keep the workers alive and to enable them to rear their children must be paid by employers; otherwise the supply of labor will fall off. But, if higher wages than these are paid, the population, and therefore the labor supply, will increase and cause wages to fall to the subsistence level again.

Malthus was mistaken in his conclusions in two respects. In the first place, he underestimated the possibilities for increasing the food supply. He did not foresee the great increases in production that were to result from inventions in farm machinery, modern methods of farming, and from improvements in breeds of cattle and kinds of plants. Nor could he foresee the advances that were to be made in chemistry, in methods of storage, and in transportation. All these have made it increasingly easy for people to get a living.

He also underestimated the importance of the rising standards of living. The desire for a higher scale of living has gradually resulted in smaller families.

How, Then, Do Demand and Supply Actually Affect Wages? Let us see now what are the conclusions concerning the influence of the demand for and the supply of labor on the wages that individuals actually receive under conditions of free competition.

(1) The marginal productivity of workers determines the maximum wages that employers can pay; but it does not always indicate the amount that they do actually pay.

(2) Whatever serves to limit the supply of labor, in proportion to the demand for labor, tends to restrict the number of workers in given kinds of work, which tends to keep marginal productivity higher than if more workers were employed. And, conversely, whatever causes an increase in the labor supply results in an increase in the number of workers that will be employed, which will cause the decrease in the marginal productivity of workers in particular kinds of work.

(3) Under conditions of free competition, employers are inclined to continue to employ workers up to the point where the marginal product—the value of the product of the last worker hired—will just equal the value of the wages necessary to induce the employee to work.

Is There Free Competition for Jobs and for Workers? In many discussions on wages it is assumed that free competition is the most important factor in fixing wages. For this reason we stated the conclusions as to how wages would be determined if free competition really existed in the labor market.

A Wage Earner and a Salaried Worker

Both of these men are employees of the same corporation. The wage earner is paid every week; the salaried worker, every month. Wages and salaries are both forms of wages.

Keystone View Co.

In a really free competitive labor market, wages would tend to equal the value of the product of the last worker of any class of workers that is employed. But in order to have competition enough to cause all workers to get wages equal in value to the value of what they produce, there would have to be a great number of employers, so that no one employer would have a monopoly of jobs. Workers in each class or kind of work would have to be alike, so that it would not matter to an employer which one he hired. Workers would have to be willing to move freely from one place to another; and it would be necessary for them to have information as to where they could obtain the highest wages possible. And, finally, there would have to be a large number of workers, so that it would be impossible for one or a few workers to monopolize the supply of labor.

In actual practice, the above conditions usually do not exist. For example, there may be only one or, at most, only a few employers in a community. Usually there are considerable differences in the quality of workers. Wage earners do not like to move from one locality to another, nor do they always know where they can obtain higher wages. In some cases the number of skilled workers is very small; and in some cases a labor union may be able to limit the number of workers who are available for particular jobs. For these reasons we can see that the price that is paid for most kinds of labor is not fixed by the same high degree of competition that determines the price of a commodity like wheat. In most cases there is an element of competition, but there are other factors that help to determine just what contractual wages shall be.

Contractual Wages Usually Result from Bargaining. Among the other factors that usually affect wage payments are custom, public authority, monopoly, and bargaining. In most localities, custom has an important influence on wages. For example, there is likely to be a customary average for the wages paid domestic and farm helpers, teachers, physicians, and others, as well as many industrial and business workers. In the case of most government employees, minimum wages are fixed by law or government agencies. Custom does have an influence on

wages in many cases. But a marked change in the demand or the supply of labor can upset the customary wage.

Where the number of employers is few and the number of workers many, the actual wage rate is likely to be considerably below the actual productivity of the workers in a group. It is easy to see why this is true. Since there are many workers, an employer who has a large degree of monopoly in the labor market is not compelled to hire any particular worker. It makes little difference to him whether he hires Jones or Smith, as long as they are of about the same ability. Therefore if the wage rate is to be determined by bargaining, the employer will hire the worker who is willing to accept employment at the lowest wage. On the other hand, since there may be few or even no other opportunities for employment, it does make a great deal of difference to the individual worker whether he gets a job with the employer. Hence, any worker may feel compelled to accept whatever wages he can get.

Can Labor Unions Raise Wages? There have been arguments about whether labor unions can actually raise wages. Without getting into a dispute as to whether the unions have really raised wages in any particular case, we can, however, make the following statements on the basis of what we have learned in this chapter: (1) Labor unions cannot for any considerable time compel employers to pay their employees on the whole more than the employees are worth, that is, more than the value of what they produce. If employers are compelled to pay out more wages than the value of the labor that employees supply, the employers will eventually go out of business. (2) If employers are not paying wages equal to the value of the productivity of the workers, labor unions may be able to create a partial monopoly of the labor supply and thus induce the employer to increase wages.

QUESTIONS ON THE CHAPTER

1. Give an illustration of wage rates.
2. What is meant by "the demand for labor"?
3. Why is it sometimes said that the demand for labor is a derived demand?

4. Why is it stated that the demand for labor is specific? What is meant by "the general demand for labor"?
5. How does the productivity of workers set a limit on wages?
6. What do you understand by marginal productivity? Give an example.
7. What is meant by dimishing productivity as it applies to labor?
8. What is meant by "the supply of labor"?
9. What are the characteristics of labor?
10. How do standards of living affect the labor supply?
11. Does income affect standards of living?
12. Explain the Malthusian theory of population. What was the relation of this theory to the "subsistence theory of wages"?
13. In most cases is there really free competition for labor and for jobs? Explain why under free competition workers would usually get wages equal to the value of their contribution to production.
14. Are contractual wages usually fixed by bargaining? What factors besides competition enter into the wage bargain?
15. Can labor unions raise wages?
16. What is the meaning of each of the following terms?

(a) **contractual wages**
(b) **derived demand**
(c) **economic wages**
(d) **implicit wages**
(e) **law of diminishing productivity**
(f) **Malthusian Theory of Population**
(g) **marginal productivity**
(h) **scale of living**
(i) **standard of living**
(j) **subsistence theory of wages**
(k) **wage rates**
(l) **wages**

APPLICATIONS OF THE CHAPTER

1. Discuss some of the problems in your community that are related to wages.
2. Report on a news item that relates to wages.
3. Discuss the subject of minimum wage laws. (Refer to the Fair Labor Standards Act of 1938.)
4. Discuss the relation between wages and the general prosperity of the country. Consider (a) the number of wage earners and (b) the relation of wages to profits and sales.
5. Alvey claims that labor is a commodity, while Kirby maintains that it is not. What arguments might be offered by each?
6. A manufacturer stated that his company would not employ anyone who had ever accepted charity or received help from the Government. He contended that anyone who wanted to work could always find work. What do you think of the manufacturer's contention?

7. John Thomson is a day laborer. He works long hours at grimy work and barely makes a living for himself and his family. Joseph Cook has worked his way up to the position of manager of a manufacturing concern. In this position his salary is twenty times the wages of Thomson. Explain all the factors that account for the differences in earning capacity. Is Thomson's work less important than Cook's? Does the theory of marginal productivity help you in your explanation?
8. In some instances workers are paid by the day. In others they are paid by the number of operations that they perform or by the number of pieces of work that they complete. Which is the better system? Does the nature of the work make any difference in the method of payment?
   Suppose that a certain establishment changes from the straight-time method of payment to the piece-rate basis. How will the piece rate be determined? What will become of the slow workers? Will the change possibly cause some employees to work harder than they did before? Who will likely gain more, the workers or the employer? Why?
9. Are professional workers paid on a piece-rate basis? Explain.
10. Do you see any relation between public vocational education and wages? What is the relation?

TOPICS FOR SPECIAL REPORTS

1. Why some motion-picture actors make large salaries.
2. Why the importance of the individual's services is not the only factor considered in the determination of his wages.
3. (a) The wages-fund theory of wages, (b) the subsistence theory of wages, (c) the bargaining theory of wages, and (d) the marginal-productivity theory of wages.
4. The following systems of wage payments: (a) Taylor system, (b) Halsey system, (c) Emerson system, and (d) Gantt system.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should there be minimum-wage laws for all industries?
2. Were Malthus' ideas as to population and wages correct?
3. Have the efforts of labor unions resulted in any important increase in wages in this country?

CHAPTER 24

INTEREST FOR CAPITAL

We shall now consider that part of the national income that goes to those who supply capital for the production of goods and services.

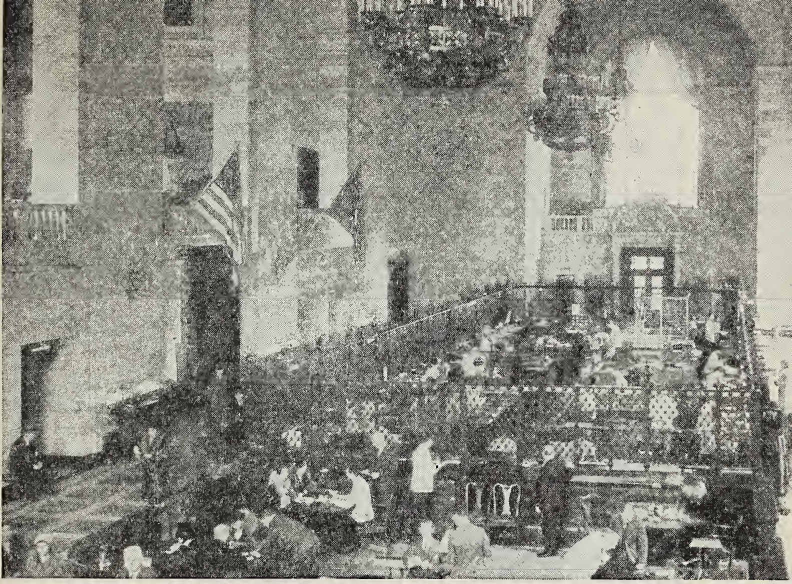
The Term "Interest" Is Used in Several Ways. In general, we may say that *interest* is the price that is paid or imputed for the use of capital. If one lends his capital to another and receives payment for its use, the amount he receives is *contractual interest,* because it is paid according to contract. *Loan interest* is sometimes used in the same sense.

Economic interest is income that arises because of the productivity of capital, whether the capital is used by the owner or by someone else. *Imputed interest* is used to mean the same thing.

In this discussion we shall use the term "loan interest" to mean interest that is paid according to contract, and "economic interest" to mean interest that results from the use of capital.

What Is the Relation of Money to Interest? The real value of machines, tools, and other equipment used in production lies in their capacity to increase the productiveness of labor. But in estimating the importance of capital goods in production, few people, other than engineers, attempt to value them in terms of products. Most of us think of their value in terms of money value.

The money value of the product of capital is the basis for estimating the actual money value of capital itself. For example, let us say that the value of the use or the product of a machine, over and above the expenses of operating it, is $400. Now if we assume that a fair rate of return on the use of the machine is 8 per cent, the value of the machine is found by dividing $400 by .08, which gives $5,000. If we assume that a fair rate is 4 per cent, the value of the machine is $10,000.



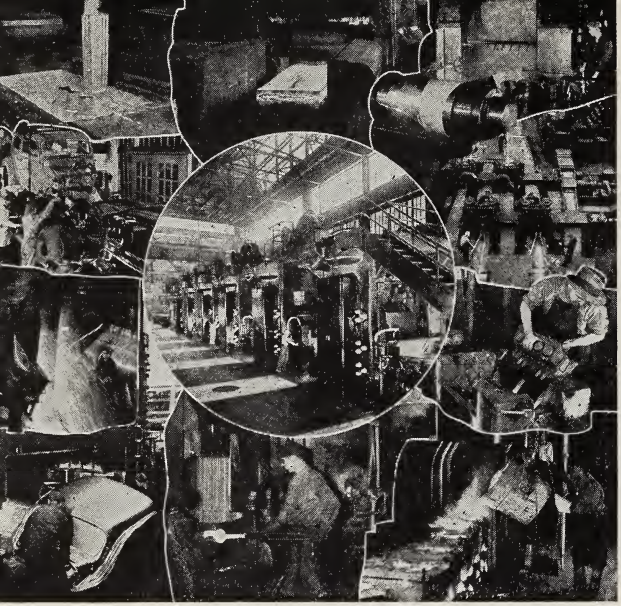
Ewing Galloway

A Large Savings Bank

Payment of interest on deposits by the bank is an inducement for depositors to save money.

Money Is Treated as Capital. As we have pointed out in several connections in this course, capital or capital goods are things that aid labor in the production of other goods. Money and credit are merely forms of purchasing power. The value of money arises because it confers upon the owner power to obtain goods. If one has purchasing power, he can use it for the purchase of consumers' goods or producers' goods. One can, if he has the money, hire labor and buy raw materials and capital goods and create producers' goods, which he can utilize in one of three ways. He can use them to produce other goods. He can sell them. Or he can lend them to others who may wish to use them in production.

It is easy, therefore, to see why money and credit are, for practical purposes, treated as capital. In our discussion in this chapter we shall treat money as though it were capital. Our reasons for doing so are that, in the first place, the possession of money enables the owner to use it to produce an income; in the second place, interest rates are stated in terms of money; and, in the third place, saving, which is the source of capital, usually takes the form of saving money.



Steps in the Manufacture of an Automobile

Millions of dollars worth of capital, which result from the savings of thousands of persons and business concerns, are used by the automobile industry.

Ford Motor Company

Interest Income Has Not Always Been Considered Moral. In former times the taking of interest was not always ethical or legal. A knowledge of the reasons why interest taking was not permitted may help you to understand some of the problems that we meet when we consider what interest is, how it arises, and what determines its rate.

In ancient Greece the word for interest was *tokos*. *Tokos* means offspring. It was considered moral for one to receive payment for the use of his land, for land was capable of producing a *tokos*, or offspring, from which payment for the use of the land might be made. But money, so it was argued, cannot produce anything of value from which the borrower could pay for the use of the money he borrowed.

In the Middle Ages, when the Christian Church had come to exert a great influence over the thoughts and the ideals of men, the taking of interest was regarded as immoral. If you have read Shakespeare's *Merchant of Venice*, you will recall that the story has to do with a loan of money by Shylock to Antonio. In the story, because Antonio was unable to repay the loan, Shylock demanded his "pound of flesh" from Antonio's body, "nearest his heart," which had been pledged in payment of the loan.

The reason why the taking of interest was forbidden was that little capital goods were used in production, and money was used largely for the purpose of buying and selling consumers' goods. When one borrows money for the purpose of purchasing consumers' goods, it is not likely that the use of the money will result in any increase in income, which would enable the borrower more easily to repay the loan. In fact, if he borrowed very much, he might become hopelessly in debt. Since there were few opportunities to use money for the purpose of constructing or buying producers' goods, money was regarded as a "barren metal" in so far as its ability to produce an income was concerned.

As time went on, however, and the use of and the need for capital goods increased, ideas regarding the taking of interest changed. It became more and more evident that capital was a factor in production. Now capital results from savings. And the way by which most people are able to save is by saving purchasing power in the form of money. The money thus saved can be used for the creation of capital goods. Therefore, as the relation between money, savings, and capital goods, which aid production, became more apparent, attitudes toward the practice of interest taking changed. Today, a reasonable rate of interest for a loan of money is considered ethical and moral.

Demand and Supply Determine Interest Rates. *Interest rates* are the prices for loans of funds. They are set by demand and supply. Competition perhaps plays a more important part in the determination of prices in the money markets than in most other markets. Purchasing power in the form of money and credit, unlike land and labor and even material commodities, tends to move to the place where people are willing to pay the highest price for its use. Therefore, as in the case of the prices of labor and of commodities, our problem in trying to understand interest largely relates to a study of the nature of demand and supply.

What Is Meant by "The Demand for Loanable Funds"? The *demand for loanable funds* is the total amount of purchasing power that borrowers will take at specific prices (interest rates)

at a given time. The total demand for loanable funds comes from two sources. One of these is the demand of those who want to buy consumers' goods; and the other is from those who desire to use the funds for productive purposes.

Borrowing for the Purchase of Consumption Goods. Those who borrow for this purpose include people of different classes. Because of the illness of themselves or members of their families, some worthy persons may find themselves in straitened circumstances. They may be in need of the bare necessities of life. There are, however, others who are habitually badly in need of money. They may receive enough income in the form of salaries or wages to enable them to get along without borrowing; but, through lack of judgment in the use of their income, they frequently find themselves without funds.

Another class of people who borrow for the purpose of buying consumption goods includes those who are forever trying to "keep up with the Joneses." To them the marginal utilities of present goods are high as compared with those of future goods. A new gown or a new and bigger automobile means much more to them now than the value that the money might have for them a few months or years hence.

Not all borrowing for the purchase of consumption goods, however, is done by the classes of persons just mentioned. Among the others who may be mentioned are young people who need money for the purchase of clothes and goods while in school or while learning some trade. Thousands of young men and women borrow money for these purposes. But, in a sense, such expenditures are of the nature of an investment. These persons expect to increase their earning capacities and thereby to be able to repay the amounts borrowed.

Businesses That Make Consumers' Loans. A great many consumers borrow from commercial banks. Most loans of this kind are usually for not more than a few hundred dollars, and the interest rates are reasonable. If the bank has any doubt concerning the borrower's ability to pay, he may be asked to deposit *collateral* as a pledge that the debt will be paid. Such collateral is usually in the form of stocks, bonds, or other personal property. Or the promissory note upon which the loan is

obtained may be signed by one or more friends of the borrower. Anyone who signs a note for this purpose is a *comaker* or *surety*.

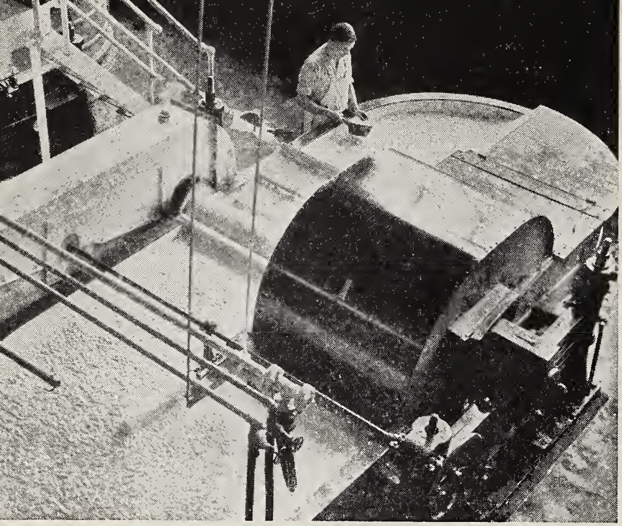
All persons in need of consumers' loans, however, are not able to borrow from commercial banks. Some of them are forced to resort to unscrupulous *loan sharks*, who charge unreasonable rates for loans. They have been known to charge interest at a rate of 1,000 per cent a year and even more.

Most of the states have laws that provide for the establishment of legitimate small-loan companies. By obtaining a license, a small-loan company is permitted to make personal loans in amounts up to $300 and to charge interest at rates that do not exceed those fixed by law. In several states the rate must not exceed 3½ per cent a month on the unpaid balance of the loan. When interest at this maximum rate is charged, the actual annual rate is 42 per cent, (the monthly rate of 3½ per cent multiplied by 12).

Many companies advertise that consumers' loans are made at a certain rate, say 6 per cent. Frequently, however, the amount of the interest is taken out in advance on the whole amount of the loan, and the borrower repays the loan in equal monthly installments. When this is done, the actual rate is more than twice the stated rate, since the borrower has the use of less than half of the funds, on which he pays interest, for the entire life of the loan.

There are a great number of *industrial* or *Morris Plan* banks that specialize in making installment loans to persons who are able to get others to sign a note with them for the loan. Many of these banks charge 6 per cent interest, which is paid in advance. A *service charge*—to cover the expense of making and collecting the loan—is usually made. As a rule, the loans run for about a year, and payments are made weekly. Where the interest rate is 6 per cent, the actual rate is approximately 16 to 17 per cent.

Borrowing for Productive Purposes. Businessmen borrow for the purpose of increasing their profits. Therefore unless they think they see an opportunity to make enough additional money with which to repay the loan, together with interest, they are not interested in borrowing money.



Manufacturing Photographic Paper

How much capital a business secures with borrowed funds depends upon whether such capital will pay for itself.

Eastman Kodak Company

Here we have a clue to the question, What is it that enables a borrower, as a result of a loan, to repay the loan? It is the productiveness of the borrowed funds. Let us see what this means.

For the purpose of demonstration, let us assume that a manufacturer has a supply of labor and factory space sufficient to enable him to use another machine that would cost $5,000, but which would not last more than one year. He estimates, however, that if he had the machine, he could increase the value of his production, over and above expenses, by more than $5,000. He talks over the matter with a friend who has some money that he would lend, and finds that he could borrow the amount by paying $250 in interest. Therefore he decides to borrow the money and install the machine.

His friend then tells him that he will lend him another $5,000 for the purchase of another machine. But the manufacturer is unwilling to borrow any more, because he thinks that the additional machine would not "pay for itself" and the interest on the loan.

Now if we consider that these amounts of $5,000 each represent units of capital, we can see that the law of diminishing productivity is in operation in the factory. Moreover, the unit of $5,000 that the owner borrowed indicated the last unit which could be used without a loss to the borrower, because the estimated returns on an additional loan of $5,000 would not be enough to repay the loan together with interest.

In the above illustration, if the manufacturer had had fewer machines, he might possibly have been willing to pay even as much as 10 or 15 per cent interest for the purchase of a machine, because he could use it to a better advantage than he could if the number of machines he owned were larger. That is to say, with fewer machines the productivity of a machine—capital—would have been higher.

As you can see, then, the marginal productivity of capital determines how much a borrower for productive purposes can afford to pay for funds. But marginal productivity does not fix the amount or the interest rate that he does or will pay.

Borrowing by Businessmen. Men in various types of business borrow money. These loans may be considered as being of two general classes: (1) short-time loans and (2) long-time loans.

When a merchant does not have the money with which to pay for goods, he either buys the goods on account or borrows the amount needed from a commercial bank. In either case he borrows capital. Such loans usually extend from fifteen to sixty days, although sometimes they are for a longer period of time.

Large companies, like manufacturing concerns and railroads, often find it desirable to borrow huge sums for the construction of plants and for the purchase of machinery. These funds are obtained for long periods of time, which may extend from several years to fifty years, or even more.

Farmers, like businessmen, borrow for both short and long periods of time.

Borrowing by Governments. Nearly all forms of government find it desirable to borrow funds for the purpose of erecting buildings and making permanent improvements of various kinds. Money spent for such purposes may be regarded as investments. These investments are undertaken for the sake of the educational and social advancement of the people in general. Examples of investments made by governments are to be found in school buildings, parks and playgrounds, roads and streets, and other kinds of fixed equipment and buildings. Besides these we may add those examples of government industries, like government-operated power dams and the post office.

The billions of dollars borrowed to finance the war were used largely for the purchase of goods to be used by the armed forces—munitions and supplies of all kinds. In addition, about 20 billions of dollars were used to build new factories and to expand old ones. These plants were built with money borrowed from individuals, banks, and many private business concerns.

Borrowing for Speculation. Speculation may be defined as buying goods or property with the expectation of selling it at a profit as a result of a change in the market price. Speculation, strictly speaking, is not a form of production, although the purchase and the sale of corporation stocks and bonds are often associated with the raising of money for productive purposes.

Many of the stocks and the bonds bought on the New York Stock Exchange, as well as on other exchanges, are bought *on margin.* This expression means that the buyer pays the stockbroker, who does the actual buying, only a part of the purchase price of the securities. The broker then borrows from a bank the remainder needed to pay for the securities. In effect, he lends this amount to the person for whom he bought the securities. The broker holds the stock certificates or the bonds, whichever are bought, as security that the buyer will pay the remainder. At any time the buyer requests, the broker will sell the securities and deduct the amount of the loan.

Speculators buy on margin. Sometimes the practice proves to be profitable; on the other hand, it may result in financial loss. For example, suppose that Mr. Hopkins has $5,500 in cash with which he wishes to buy some shares of the stock of the East-West Corporation and that these shares are selling on the exchange at $10 a share. He feels that the price of the stock will go up shortly and that if he buys now, he will be able to sell at a profit. As you can see, he can buy 550 shares, not counting the commission that he would have to pay the broker. If the price of the stock should rise to $11, he would make $550 by selling it.

The broker, however, is willing to borrow $4,500, the amount needed in addition to the $5,500 to buy 1,000 shares, and lend it to Mr. Hopkins. Then, if the price of the stock should rise

Buying and Selling on a Stock Exchange

The hope of making a speculative profit because of an expected future change in prices of securities is the reason for most of the trading on exchanges.

New York Stock Exchange by Gottscho-Schleisner

to $11, Mr. Hopkins would make $1,000 by selling. On the other hand, if the price of the stock should fall to $9, he would lose $1,000 by selling.

What Is the Meaning of "The Supply of Loanable Funds"? By the *supply of loanable funds* we mean the amount of funds that people and business concerns will lend at specified prices, or interest rates, at a certain time. The interest rate tends to affect the supply of loanable funds in the same way that the market price affects the supply of commodities or labor. A rise in the interest rate tends to cause the supply of funds to increase; while a decline in the rate tends to result in a decrease in the supply of funds.

Of course, if people feel that there is danger that borrowers may not be able or willing to return the amount borrowed, or that the value of money in the future will become less, a rise in the interest rate may not result in an increase in loanable funds.

Would there be any savings if there were no possibility of obtaining interest? The answer is that there would be some savings by persons and business concerns even if it were impossible to lend money at interest. But there would not be enough funds to meet the demand. And because the supply of loanable funds is limited, it is necessary to pay interest in order to obtain the use of part of the total supply of funds that are in existence at any time. This is the answer to the question, Why is it necessary for borrowers of funds to pay interest?

What Are the Sources of the Supply of Loanable Funds? There are four general sources of loanable funds: (1) the savings of individuals, (2) the savings of business concerns, (3) the extensions of credit by banks, and (4) the extensions of credit by government.

Savings of Individuals. A majority of individuals find it impossible to save more than a very small part of their incomes each year, regardless of how high the interest rate may be. In fact, there are many who are unable to save anything. On the other hand, there are some who find it easier to save a great deal of their income than to spend it all; but there are relatively few such individuals and families. Most of the savings by individuals are made by those who belong to the middle and upper economic classes. A few years ago it was estimated that 20 per cent of all individual savings came from those whose incomes were $5,000 or more, although the number of such persons made up only 2.5 per cent of all persons receiving incomes in the United States. At the same time, those with incomes of $1,000 a year saved 18 per cent of the total amount saved by individuals, and their number constituted 40 per cent of all income receivers.

Savings of Business Concerns. A considerable part of the total savings in this country is in the form of the savings by business concerns, especially corporations. The decision as to what part of the profits of a corporation shall be retained by the business rests with the board of directors. As a rule, most of the savings are used for the purchase of new or additional equipment and for extensions of the business. Usually, however, some portion of the amount not paid out to stockholders is invested in bonds and other securities of other corporations and thus becomes available for use in the construction of capital goods. Some of the savings may also be deposited in banks.

Extensions of Bank Credit. Most of the funds available for loans are provided by banks. These funds are created by extensions of credit to borrowers. For example, a merchant desires to borrow $1,000 for 60 days. He goes to his bank and gives acceptable evidence that he will be able and willing to repay the

loan at the end of that time, and he gives the bank his promissory note. The bank then extends him credit for $1,000, less the amount of interest or discount. When the merchant uses the borrowed funds, he usually writes a check payable to someone to whom he owes an amount of money. When the check is presented to the bank for payment, the amount is paid in cash and is deducted from the amount of the deposit of the merchant. Or if the holder of the check is a depositor in the bank, the amount of the check may be deducted from the merchant's account and added to that of the depositor.

Thus the bank does not have to save funds before it lends them. As we saw in Chapter 17, banks lend credit on the basis of their reserves of money and credit. And the amount of these reserves largely comes from the savings of individuals and business concerns. Hence savings are a factor in the extension of credit by banks.

Extensions of Credit by Government. Sometimes governments extend credit to borrowers. When they do, they are really performing a function of banks. For example, since 1932, the Reconstruction Finance Corporation, which is owned by the Federal Government, has loaned many billions of dollars to banks and other financial institutions and to railways. The basis, or reserves, for the loans by the RFC are the funds borrowed by the Government.

How Do Demand and Supply Affect Interest Rates? We are now prepared to summarize what we have said about the relation of the demand for and the supply of loanable funds. On the side of demand, we found that it is the marginal productivity of capital that determines how much a borrower for productive purposes can afford to pay. On the supply side, we found that it is necessary to pay some people and business concerns to save in order that the supply of funds may be sufficient to satisfy the demand for funds.

Like the price of a commodity where competition exists, the price of funds—the interest rate—is fixed at the point where demand and supply are equal, or in equilibrium. Anything that affects either the demand for or the supply of loanable funds will tend to result in a change in the interest rate.

Should Interest Rates Be Regulated by Law? A few states have laws fixing the maximum rates of interest. The general purpose of these laws is to limit the rate of interest that may be charged for certain types of loans. But there are so many ways of getting around these laws that borrowers for productive purposes may evade them without breaking the law. Suppose the law fixes the maximum rate at 6 per cent. A company may put out an issue of $1,000 bonds with interest at 6 per cent. It would then pay $60, or 6 per cent, a year on each bond. However, if the company could sell the bonds for only $900 each, the real, or effective, interest rate that it would have to pay would be nearly 6.7 per cent ($60 divided by $900), because it would pay interest on $1,000, although it received only $900 when the bonds were sold.

It is generally agreed that government should do something to protect needy borrowers from "loan sharks." But many persons argue that it is futile, and often harmful, for government to try to exercise a large amount of control over interest for loans that are used for production. Where government tries to reduce interest rates for loans used in production, the result may be a decrease in the amount of the savings of individuals and business concerns. If this happens, interest rates will tend to rise because of the decrease in the supply of capital.

QUESTIONS ON THE CHAPTER

1. What is the relation of money to interest?
2. How is the interest rate calculated?
3. Why is money treated as capital in the study of interest?
4. Has it always been considered right to take interest? Why or why not?
5. Do demand and supply determine interest rates?
6. What are the sources of demand for loanable funds?
7. Distinguish between the "stated" and the "actual" interest rate.
8. How are funds used for productive purposes? What classes of people borrow for productive purposes?
9. Explain what is meant by the marginal productivity of capital, and give an example.
10. How does the marginal productivity of capital affect the interest rate?
11. Distinguish between long-time and short-time loans.

12. What is meant by buying securities "on margin"?
13. What are the sources of loanable funds?
14. Show how the demand for and the supply of loanable funds are related to the interest rate.
15. To what extent should interest rates be regulated by law?
16. What is the meaning of each of the following terms?

(a) **collateral**	(h) **interest**
(b) **comaker**	(i) **interest rate**
(c) **contractual interest**	(j) **loan interest**
(d) **demand for loanable funds**	(k) **loan shark**
	(l) **service charge**
(e) **economic interest**	(m) **speculation**
(f) **imputed interest**	(n) **supply of loanable funds**
(g) **industrial bank**	(o) **surety**

APPLICATIONS OF THE CHAPTER

1. Report on some current newspaper item or magazine article dealing with the subject of interest.
2. (a) If capital accumulates faster during periods of prosperity than during periods of depression, what is the implication? Does it mean that the more we spend, the faster capital will accumulate? Or does it mean that people save more during periods of prosperity? What is the effect of reckless spending on the accumulation of capital?
(b) When too much is spent by people for one type of goods, how does such spending affect the accumulation of different kinds of capital?
3. Using quotations from Shakespeare's *Merchant of Venice*, show how attitudes toward economic matters may affect ideas as to what is right and wrong. (Consider the economic questions involved in the relations between Antonio and Shylock.)
4. Show by an example how the productivity of capital affects the rate of interest.
5. Discuss the importance of interest. Consider (a) the relation of interest to savings, (b) its relation to the value of property, and (c) its relation to business activity and prosperity.
6. Show the relation between interest and the ownership of property.
7. It has been said that interest arises from differences in the relative values of the present and the future utilities of goods and money. What is meant by this statement?
8. What would be the results if all interest were abolished by law? Would anyone save? Why? Would there be any factories? What would happen to banks? How would the abolition of interest affect consumers? Should the rate of interest be controlled to any extent by law? Why?

9. The rate of interest is usually higher in a new country than in an old country. Can you account for this difference? How?
10. Can you account for the fact that some bonds carry a higher rate of interest than do others?
11. Why can the United States Government usually borrow money at a lower rate of interest than can a private enterprise? Suppose the Government desired to build a power plant that would be operated in competition with a private plant. Of what importance is the fact that it could borrow funds at a lower rate of interest than could the private concern? Would its borrowing at such a rate of interest affect the price of electricity? Would the building of the plant affect private investors?
12. Does large borrowing by the Government at low rates of interest affect the rates of interest that private borrowers have to pay?

TOPICS FOR SPECIAL REPORTS

1. The abstinence theory of interest.
2. Different interest rates; e. g., call rates, short-term paper rates, bond rates, commercial-bank rates, savings-bank rates, etc.
3. Why interest rates vary in the United States from time to time or place to place.
4. Interest rates in old and in new countries.
5. The attitude of socialism towards interest.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Does saving involve sacrifice?
2. Are rent and interest fundamentally alike?
3. Can interest rates be regulated effectively by law?
4. Should small-loan companies and individuals who lend without good security be allowed by law to charge more than 6 per cent interest?

CHAPTER 25

PROFITS FOR RISK TAKING

The fourth share of the national income is a reward for risk taking or risk bearing. The reward in the form of profits goes to those who bring together land, labor, and capital and undertake to produce and sell a product for more than it costs to produce it.

What Is Meant by "Risk Bearing"? In the production of goods there are many kinds of risk. For example, if a farmer uses his land, capital, and labor for the production of a crop of corn, he has to assume several risks. After he has planted the seed, several things may happen that will affect the yield. If the season is wet and cold, many of the seeds may not come up. And if they do, unseasonable weather and pests may reduce the yield or even destroy the crop entirely. But if he succeeds in producing a good crop of corn, will he be able to sell it for more than it cost him to produce it? That all depends upon the market price, which, in turn, depends upon the demand for and the supply of corn. The price may be so low that he will not be able to make as much on the sale of his corn as he could have obtained if he had worked for wages and allowed someone else to use his farm.

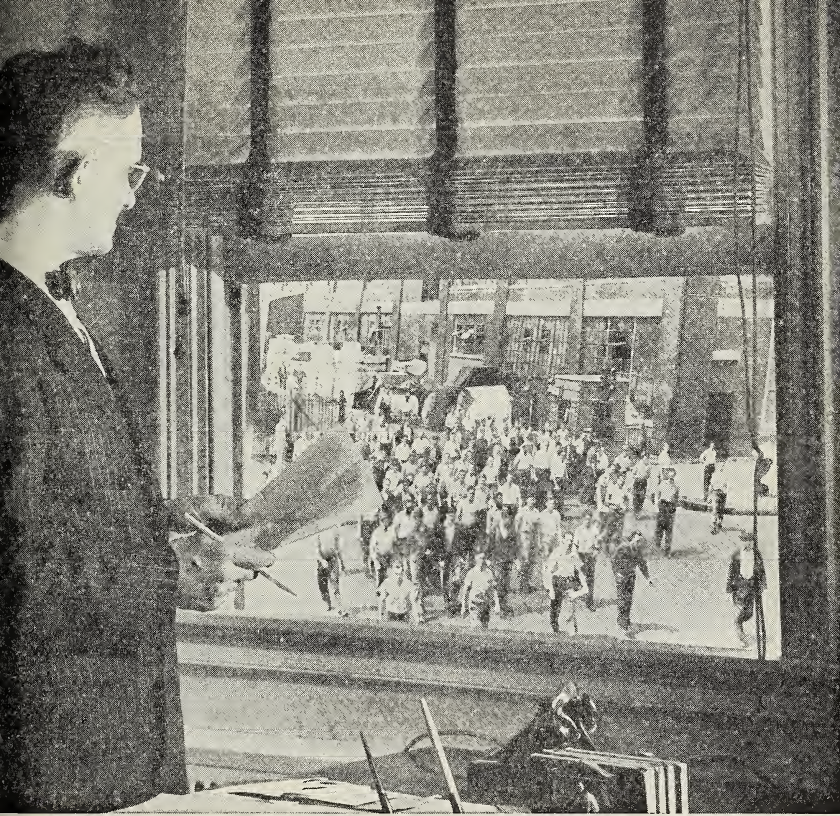
Likewise a merchant assumes many risks. The grocer, for example, uses his capital and generally borrows additional amounts, rents or buys the use of real estate, and hopes to sell his goods for more than they cost him, including the value of his own services and that of his capital. But fire or storms may injure his stock of goods, thieves may steal from him, his employees may be inefficient and wasteful, he may not use good judgment in buying goods, and prices in general may fall—any one or all of which may cause him to suffer a financial loss.

Risk Bearing Is Essential to Production. Some of the risks of production may be lessened or partially shifted by farmers, manufacturers, grocers, and other kinds of producers. For example, insurance policies will give at least partial protection against loss from fire, storms, or theft. And a knowledge of business conditions may help business managers to avoid some kinds of situations that would result in financial losses. But there are some kinds of risks that, under our system of free enterprise, must be borne by someone. These risks, in general, are those that come from possible future changes in the demand for and the supply of goods. If one could predict exactly how many goods of all kinds he could sell at certain prices and could determine in advance how many goods he could produce, there would be less risk in production. But no one can do these things.

Profit Is the Reward for Risk Taking. A man who puts his own land, labor, and capital into a business is an entrepreneur or business enterpriser. As these terms are used, he is a risk taker, because he assumes certain risks that relate to the possible income from his business.

Strictly speaking, however, the entrepreneur does not have to furnish any land, labor, or capital. As an entrepreneur, his primary function is to assemble these other factors for the production of goods. He may do this by renting land, hiring labor, and borrowing capital for which he agrees to pay rent, wages, and interest. If he is able to sell the goods for more than he pays out in the way of rent, wages, and interest, he will have an amount left over, which will be his reward for the risks he assumed when he undertook to produce the goods.

Of course, if an entrepreneur obtains land, labor, and capital from others, they run some risk, too. It might be that he could not or would not pay them the agreed amount of rent, wages, or interest. But it is the entrepreneural risks that result in profits. The entrepreneur assumes the risk of paying the owners of the other factors and of being able to sell his product for more than he pays out in costs. Or if he furnishes part of the land, labor, or capital, he will have to make an allowance for the use of the factors that he furnishes in calculating his profit.



Harold M. Lambert

Risk Bearing

Someone must take the risks of bringing land, labor, and capital together for productive purposes. Profit is the entrepreneur's reward for assuming such risks.

The Term "Profits" Has Many Meanings. In business the term "profits" has several meanings. For that reason it is necessary that we understand what is meant when the term is used.

Competitive profits are profits that are earned by a business or an industrial concern that competes with others in the sale of its products. *Monopoly profits* are those that are received by a concern that controls the supply or the prices of the goods or the services that it sells. *Speculative profits* are profits that are made by buying and selling goods as a result of a change in prices.

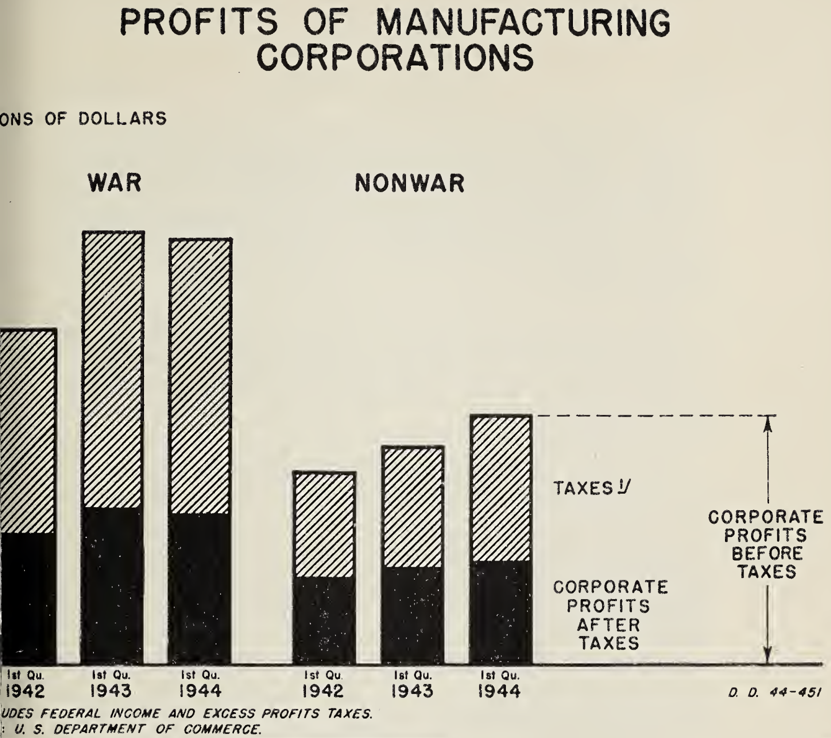
Gross profit is the difference between the amount that is paid for goods and the amount that is received when the goods are sold. *Net profit* is the amount remaining after the total amount of all expenses has been deducted from the gross profit.

Pure profit is the amount remaining to the owner after an allowance has been made for the use of the owner's own services, his land and other capital, and payment for the services, land, and capital belonging to others that may have been employed in the enterprise.

How Is Pure Profit Calculated? A simple example will illustrate how pure profit is calculated. Suppose that Fred Johnson engages in a grocery business. At the end of the year he determines (1) the sales, (2) the cost of goods sold, (3) the gross profit, (4) the expenses, and (5) the net profit. After the amount of net profit has been found, allowances are made for imputed interest on Johnson's capital (6) and for his own labor (7). The total amount of these allowances is deducted from the amount of net profit, and the remainder is considered pure profit (8).

(1) Sales		$40,000
(2) Cost of goods sold		30,100
(3) Gross profit		9,900
(4) Expenses:		
Rent on lot and storehouse	$2,400	
Wages of salesman	1,200	
Interest on bank loans	300	
Miscellaneous expenses	2,000	5,900
(5) Net profit		4,000
To calculate amount of pure profit, allow:		
(6) Interest at 5% on owner's capital of $10,000	$ 500	
(7) Value of owner's wages	2,400	2,900
(8) Pure profit		$ 1,100

This example illustrates the residual nature of profits. It shows that profit is the amount of income that remains after each of the other factors of production has been allowed its share of the income of the business.



Wartime Profits

Corporations engaged in making munitions and other war goods made much more profits than those making nonwar products. But in each case the Government took more than half of the total profit by means of taxation.

In ordinary usage the term "profit" means the amount remaining after the cost of goods sold and the expenses of carrying on the business have been deducted. In this discussion, however, the term "profit" will be understood to mean pure profit. It is convenient for our present purposes to restrict the meaning of the term in this way so that the rewards of the four factors of production can be kept separate.

Wages of Management Are Not Profits. When one manages his own business enterprise, he is entitled to think that a part of his net income, if any, above expenses should be considered as implicit wages or wages of management. When calculating the amount of pure profit, the owner should make allowances for

the use of any or all of the factors of production that he furnishes. Therefore pure or economic profit does not include wages of management. For this reason we say that the manager of a corporation, unless he gets part of his compensation from profits, is not an entrepreneur. In reality his salary is only a form of wages.

What Are the Sources of Profits? There are three underlying sources of profits. These sources are (1) superior efficiency in risk taking, (2) gains resulting from a degree of monopoly, and (3) chance.

Superior Efficiency in Risk Taking. Some men and women are better business managers than others. This is true whether they own their own businesses or whether they work as hired managers, as do those who run corporations. Those who possess exceptional managerial ability know how to keep down expenses so that the unit costs of production are kept at a minimum. They know where, when, and how to buy goods and materials at low prices; how to bargain successfully with workers; how to obtain the use of capital at low interest rates; and how to put new ideas into practice.

Those enterprises that are fortunate in having good management are more likely to make larger profits than are those whose management is inferior. For example, if the stockholders of a corporation elect a capable board of directors, who in turn employ efficient managers, the profits to the stockholders are likely to be larger than if less efficient managers were chosen.

Imperfect Competition and Monopoly. If all businesses were purely competitive, there probably would be no profits. All the national income would go to the owners of land, labor, and capital. But, as we have said in several connections, pure competition seldom, if ever, exists. In order to have pure or perfect competition, everyone would have to know exactly where he could buy at the lowest price or sell at the highest price, and there would have to be so many buyers and sellers that what anyone bought or sold would make no important difference in the market price.

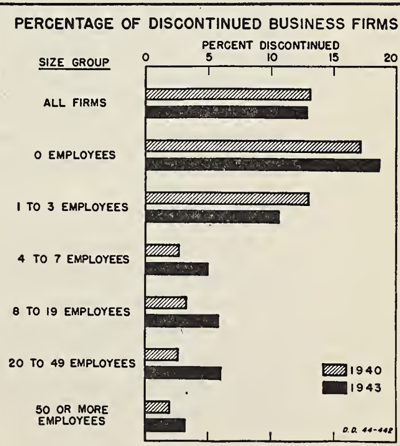
You will recall, from Chapter 13, that nearly all manufactured products of any kind are different in some respect. Sometimes the only difference is in the brands. But some people prefer one brand of flour, bread, or coffee to others. So, regardless of whether there is any real difference between two or more kinds of a product, as long as people think there is, the maker has a better chance of selling the product that buyers prefer. And the more people who prefer his product, the more nearly the maker comes to having a monopoly on the sales of that product.

Of course, if he is the only one who can supply a particular product or service, the price he can charge for what he sells depends only upon how badly people want the product; that is, the amount that he can sell depends upon the elasticity of the demand.

As we know, there are a few cases of absolute monopoly. But for the most part, business is neither purely competitive nor purely monopolistic; it is somewhere between these two extremes. And the chances of making a profit usually are affected by the amount of competition that exists.

Chance. Through the discovery of oil on their property, some owners of very poor farms have become rich. Owners of some land have reaped fortunes because of the rapid development of real estate values. Accidental inventions have made inventors wealthy. These are some spectacular examples that illustrate how chance has brought great profits to certain fortunate individuals.

More often, however, chance gains are on a smaller scale than those referred to above. For example, a rise in the market price of corn, lumber, or other farm and manufactured products bring profits to those who owned them before the rise in



Discontinued Businesses

More small concerns than large ones discontinue business for various reasons.

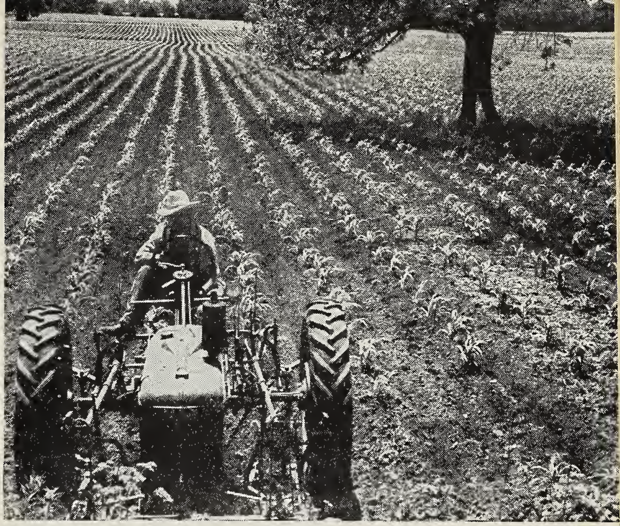
price occurred. Those who profit from circumstances that they did not anticipate are said to be lucky. And the element of chance or luck is sometimes an important factor in accounting for profit. Of course, unforeseen changes in prices and other circumstances may also result in losses.

Are Profits Necessary? It is sometimes said that profits are necessary if goods are to be produced. This statement, however, is not strictly true. For it is the hope of making a profit, not the certainty of making a profit, that causes entrepreneurs to undertake production. There are concerns that never make any profit, but they go on producing goods.

Of course, if everyone were convinced that there was no hope of his making any profit, it is hard to see what motive most people would have for risking the use of their land, labor, or capital in the production of goods for sale. Likewise, one would have no motive for hiring the use of the factors of production for use in producing goods for the market if he knew he could not make any profit.

Just how much profits are necessary to cause entrepreneurs to assume the risks of production? Where risks are great, the amount of possible profits must be larger than when the risks are considered to be less. For example, it is generally considered that private individuals and companies would seldom risk their capital in drilling oil wells if the profits they could make were small. On the other hand, some public utilities whose profits are regulated by government have little trouble in obtaining the use of all the capital they need. The reason is that, since the business is a monopoly and is protected from competition, owners will risk their capital by buying stock and bonds in the enterprise.

What Are Some Results of Unrestrained Profit Seeking? Free enterprise implies the production of goods for profit. In the development of the United States and most of the nations of the Western World, the free enterprise system has prevailed. Under this system a great deal of national wealth has accumulated, especially in the United States, and many great family fortunes have been built up. All of these fortunes came



Cultivating a Corn Field

The farmer hopes to sell his corn for more than it costs to produce it, but he must run several risks.

U. S. Department of Agriculture

from profits. It is impossible to build a fortune of many millions of dollars except from profits.

The American people, on the whole, believe strongly in the free enterprise system. At the same time, it has come to be recognized that it is sometimes necessary to impose certain restrictions upon the means and practices employed in seeking profits. For example, if business concerns are permitted to use certain methods in doing business, they may force all others who would compete with them to go out of business. As a result, the shrewdest and most ruthless individuals would come to control concerns that would be so large that they could fix their own prices. They might possibly even be able to control the policies of those who are elected to run government.

Unrestrained profit seeking may lead to waste and exploitation. It is now generally recognized that the desire for quick profits has in the past resulted in the waste of much of our oil, gas, timber, and other natural resources. Much oil and gas have been burned by fires at the time wells were drilled because proper precautions were not taken to prevent fire. Great quantities of young timber have been ruined by careless and reckless methods in cutting trees.

Where they have the power to do so, it has been charged that those companies which have a monopoly of the demand for labor have often been able to obtain workers at wages that were much less than the workers were worth. Until a few

decades ago, great numbers of children who should have been in school were working in factories at low wages. It has often been asserted that low-priced labor has frequently been the reason for large profits in some industries. This, of course, does not imply that any particular employer was cruel and selfish. As long as child labor is permitted, the employer who is unwilling to take advantage of an opportunity to obtain workers at low wages is at a disadvantage when competing with another producer who does use the services of children and other low-paid employees.

Should Profits Be Limited by Law? This question has often been debated. From time to time, especially in time of war, laws to limit profits have been proposed, and some of them have been enacted. But even in times of peace, there are those who would put definite limits upon the amount or the per cent of profit that a company would be allowed to make. Those who advocate restrictions on profits say that limitations are necessary in order to prevent some individuals and concerns from getting too much power. Others reply that any important restrictions upon profits is contrary to the traditional American ideas of business.

As time goes on, you will hear more about this subject. It is an important subject, because it involves the fundamentals of the free enterprise system. If all possibilities of making profits are removed, the free enterprise or capitalistic system will disappear. On the other hand, this does not mean that there should be no restrictions on the making of profits. It seems, therefore, that the real question is, When and how much restriction upon profit seeking may be necessary and desirable under particular circumstances?

QUESTIONS ON THE CHAPTER

1. What is meant by "risk bearing," as the term is used in this chapter?
2. What are some of the types of risk that entrepreneurs bear?
3. Why is risk bearing essential to production?
4. Explain what is meant by the expression, "Profit is the reward for risk taking"?
5. Explain how pure profit is calculated.

6. Should wages of management be considered as a part of profit?
7. How do the following help to account for profit: superior efficiency in risk taking, gains resulting from a degree of monopoly or imperfect competition, chance?
8. Are profits necessary? Why or why not?
9. What are some of the results of unrestrained profit seeking?
10. Should profits be limited by law? Why or why not?
11. What is the meaning of each of the following terms?

    (a) **competitive profit**
    (b) **gross profit**
    (c) **monopoly profit**
    (d) **net profit**
    (e) **pure profit**
    (f) **speculative profit**

APPLICATIONS OF THE CHAPTER

1. Report on a current newspaper item or magazine article dealing with the subject of profits.
2. Discuss instances in which persons work for profits and some in which they work for wages. Compare the responsibilities of wage earners and entrepreneurs and the possibilities for earning income in both cases.
3. Give a report on how some of the great American fortunes were built up. (The report may deal with any of the following fortunes, or others: Gould, Astor, Vanderbilt, Rockefeller, Carnegie, Morgan, Ford, Hearst, Mellon. See reference books in your school library.)
4. What are the risks in farming, merchandising, manufacturing, mining, lumbering, fishing, and other kinds of production?
5. What motives besides that of making profits may one have for entering business for himself? Are they as important as the profit motive?
6. Oscar Darter says that he made $5,000 profits last year from his store. What expenses did he have to consider?
7. Young and Cook are discussing the subject of profits. Young says that profits can come into existence only when business is competitive. Cook contends that this statement is not necessarily true. What do you think?
8. It has been said that, if the earning of profits were abolished, the Government would have to decide what should be produced, to assume the risks of production, and to compensate the owners of the factors of production. Would anyone be capable of deciding how many pairs of shoes or pounds of beef the people will need next year? Does every individual desire the same quantity of each commodity? How are these two questions answered at the present time? How would they be answered if the Government controlled production?

9. It has been stated that the profit motive was responsible for the settlement and development of the United States. Show how and why this is true. Was the desire to obtain profits the only motive involved?
10. In what ways has the desire to make profits resulted in waste?
11. It has been suggested that no one should be allowed to inherit more than five million dollars and that the Government should get a part of all large estates. How, if at all, would profits be affected by a high inheritance tax? by an excess-profits tax?
12. It has been stated that the function of the entrepreneur is to bear the noninsurable risks incidental to production. Do you agree? Discuss.
13. What industries are affected by the following: war, changes in the seasons, changes in the trade restrictions between nations, taxes on income, taxes on property? Show why the manager of a business concern should be interested in such matters.
14. Is it likely that the profits in any industry or business always tend to decrease as the industry or business grows older? Discuss the reasons for your answer. Are there exceptions to the rule? What are they?
15. Is a business concern entitled to all the profits it can make? Discuss.
16. If the Government undertakes to limit the amount of profit that a concern may make, what factors should be considered? Discuss fully.
17. What are speculative profits? Should speculative profits be controlled? How?
18. How does the profit motive tend to produce economy in production? Give examples.

TOPICS FOR SPECIAL REPORTS

1. A comparison of the origin, the certainty, and the importance of profits with those of rent, wages, and interest.
2. The qualities needed for success as an entrepreneur.
3. How far the Government should go in the regulation of profits.
4. Do large profits always mean high prices of goods?
5. Who gets the profits made by corporations?

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should the tax rate on large corporations be higher than that on smaller corporations?
2. Should any concern be allowed to make an amount of profit greater than 7 per cent of the capital invested?
3. Should all speculative profits be limited by law?
4. Is chance as important a factor in the making of profit as is business ability?

UNIT VII

Economic Welfare

Important problems involved
in the distribution of income
among those who produce it.

Ewing G[illegible]

Economic Welfare

A comfortable scale of living requires
a sufficient amount of income

CHAPTER 26

DIFFERENCES IN INCOME AND WEALTH

America is the richest nation on earth. In no other country are there so many automobiles, improved farms, great factories, miles of railways, paved roads, telephones, comfortable homes, and well-fed and well-dressed people. In no other country are things done in such a big way. And in few, if any, other countries are there so many natural resources from which goods in an almost endless variety can be made.

The *per capita income* in the United States, which is the average income of all the people in the nation, is high. For example, the income per capita in 1942 was estimated at $852; and in 1943, at over $1,000. For a family of four that would have meant an income in 1943 of more than $4,000, which, even in times of high prices, should have enabled a family to live very comfortably. And there are a great number of families with incomes of that amount. There are thousands of families who receive enough to enable them to live in comfort and security all their lives. A relatively few families have more wealth and income than they can spend conveniently, even though they live in luxury far beyond the dreams of the middle-class citizen.

Unfortunately, however, per capita income does not give a true picture of the way a majority of the American people live. The fact is that millions of families do not receive enough income to enable them to live on a level of comfort, according to the ideas of the middle class. Even when there is no sickness in the family and employment opportunities are fairly good, most families are unable to lay aside sufficient savings to tide them over emergencies, such as periods of illness or unemployment. Those who are eligible to receive social security benefits are able to maintain themselves above the level of absolute want, provided they do not need expensive medical services.

The inequality of wealth and incomes should concern every person who aspires to be a good citizen. While few people would

contend that there should be equality of income, great extremes of income may indicate that something is seriously wrong in the social and economic order. Certainly we should be interested in knowing how great the inequalities are and what are their causes.

What Is the Per Capita Income by States? The table on page 413 gives the per capita income in dollars by states in 1939 and in 1942. In 1939 the income in the states of the Middle East was highest, followed, in order, by that in the Far West and New England. Income was lowest in the states of the Southeast.

The increase in per capita income between 1939 and 1942 was due to the great increase in employment because of the war. And the increase in income refers largely to money income only. It was not due to an increase in the production of consumers' goods, because nearly half of the labor of the nations was devoted to the production of war materials.

As you see, the per capita income increased nearly 60 per cent from 1939 to 1942. Moreover, in some of the states the increase was over 100 per cent, while in others the increase was not nearly so much.

But we should not conclude that in those states where per capita income doubled, all the people were twice as well off as they were before. In the first place, prices increased sharply from 1939 to 1942, which caused money to lose part of its purchasing power. In the second place, many people did not receive increases in income equal to the average. In fact, some of them received no money increase at all. On the other hand, there were some whose incomes increased much more than the average. These fortunate individuals therefore were much better off in spite of the increase in prices.

Per Capita Income Does Not Indicate How Well Individuals Live. There are probably millionaires in each of the states. Likewise there are some people in any state who are as poor as are those in any of the others. Therefore the per capita income for a state, or for the United States, does not give any reliable indication as to how well a majority of the people live. The un-

PER CAPITA INCOME BY STATES

Region and State	1939	1942	Region and State	1939	1942
UNITED STATES	$ 539	$ 852	SOUTHWEST	$ 386	$ 661
			Arizona	461	832
NEW ENGLAND.	680	1,026	New Mexico	341	558
Connecticut	754	1,296	Oklahoma	340	598
Maine	474	786	Texas	401	677
Massachusetts	719	1,024			
New Hampshire	548	719	CENTRAL	565	891
Rhode Island	678	1,016	Illinois	671	979
Vermont	483	698	Indiana	495	827
			Iowa	468	823
MIDDLE EAST	709	1,039	Michigan	591	960
Delaware	771	1,186	Minnesota	497	761
Dist. of Columbia	1,031	1,164	Missouri	486	762
Maryland	634	1,077	Ohio	603	957
New Jersey	816	1,304	Wisconsin	485	786
New York	804	1,106			
Pennsylvania	589	894	NORTHWEST	419	792
West Virginia	378	598	Colorado	505	785
			Idaho	411	758
			Kansas	383	814
SOUTHEAST	303	522	Montana	515	860
Alabama	242	480	Nebraska	397	774
Arkansas	246	514	North Dakota	325	721
Florida	442	655	South Dakota	351	725
Georgia	290	498	Utah	443	850
Kentucky	297	477	Wyoming	567	883
Louisiana	354	534			
Mississippi	201	407	FAR WEST	692	1,157
North Carolina	308	523	California	741	1,167
South Carolina	261	459	Nevada	767	1,352
Tennessee	295	492	Oregon	544	1,046
Virginia	402	697	Washington	588	1,166

reliability of average income as a measure of the economic well-being of a majority of the persons within a state or nation can be seen from a simple illustration. Suppose that Smith has an income of $1,000,000, while that of Jones is $100 and that of Williams, $10. The per capita income of the three men would be $333,370! But would this figure mean very much to Jones and Williams? Certainly they could hardly expect to use per capita income with which to buy food or to pay debts. Therefore per capita income and wealth have meaning, in so far as they indicate economic well-being of the people, only if there are no great variations in the way the actual income or wealth is distributed.

How Well Do the American People Live? To give a meaningful answer to this question, we should have to talk in terms of meat, bread, milk, butter, and other items of food; of shoes, dresses, coats, and other articles of clothing; of rooms, furniture, and other things that are involved in housing and shelter; and of books, shows, travel, music, and the other kinds of goods and experiences that are necessary to live a full and happy life. But to give an answer in terms of all these things would be an impossible undertaking.

It is easier to try to get an idea of how well people live by learning how much income they receive. If we have this information, then by knowing about how much things cost, we can form an idea as to how well they live.

Several well-known attempts have been made to find out approximately how the money income of the United States is distributed. A comprehensive attempt of this kind was made by the National Resources Committee for the year 1935-36. The Committee estimated that at that time there were about 39,460,000 consumer units in the nation, a *consumer unit* being a family or an unattached individual not living with his family. For the year the national income was estimated at $59,259,000,000. How this amount was distributed is shown in the following table.

SIZE DISTRIBUTION OF CONSUMER INCOMES IN THE U. S. 1935–1936

Income Level (Dollars Per Year)	Consumer Units		Aggregate Income		Average Per Consumer Unit
	Number	Per Cent of Total	Dollars	Per Cent of Total	
Total........	39,460,000	100.00	$59,259,000,000	100.00	$ 1,501
Under $500	6,710,000	17.01	2,061,000,000	3.48	307
$ 500– 1,000	11,650,000	29.52	8,745,000,000	14.76	751
1,000– 1,500	8,730,000	22.12	10,698,000,000	18.05	1,225
1,500– 2,000	5,190,000	13.15	8,875,000,000	14.98	1,710
2,000– 3,000	4,440,000	11.25	10,577,000,000	17.85	2,382
3,000– 4,000	1,350,000	3.42	4,599,000,000	7.76	3,407
4,000– 5,000	460,000	1.17	2,045,000,000	3.45	4,446
5,000–10,000	600,000	1.52	4,092,000,000	6.90	6,820
10,000–20,000	220,000	.56	2,922,000,000	4.93	13,282
20,000 and up	110,000	.28	4,645,000,000	7.84	42,227

U. S. Housing Authority

Poverty

Families with low incomes cannot afford to live in the more desirable residential districts.

The Committee stated that the lower third of the consumer units of the nation in 1935-36 received incomes of less than $780, with an average of $471. The middle third received incomes ranging from $780 to $1,450, with an average of $1,076. The upper third of the consumer units had incomes of from $1,450 to over $1,000,000.

Few people in this country think that incomes should be equal. But if the national income had been equally distributed in 1935-36, each consumer unit would have received a little over $1,500. If the national income for that year had been as high as it was in 1944, the average income per consumer unit would have been more than double that amount.

How Much Income Is Necessary in Order to Live Comfortably? It would be impossible to get everyone to agree on an answer to this interesting question. A few years ago the Bureau of Home Economics of the United States Department of Agriculture conducted an investigation in order to try to

determine how much it costs to maintain an adequate diet for health and efficiency. The Brookings Institution has also studied the problem of the distribution of incomes and has given some interesting estimates concerning the number of people living on the several economic levels in 1929. From these and other studies, we would be justified in saying that an income of at least $1,500 would be necessary to maintain a family on a level of minimum comfort, when the cost of living was what it was in 1935-36. An urban family with an income of less than this amount could hardly live on a scale above the poverty level. Many would insist that the figures are too low. Others might say they are too high. At any rate, a family of three or four with an income of less than $1,500 could afford few luxuries, nor could it pay out much for medical attention or lay aside many dollars as savings.

On the basis of these estimates we would have to conclude that in 1935-36 at least 65 to 70 per cent of the people could not afford sufficient food, clothing, and shelter for health and efficiency and at the same time put aside more than the meagerest amount in savings.

Because of war conditions that resulted in increased wages for a great many workers, it was estimated in 1944 that about 33 per cent of the families in the United States had incomes of

Superfortress Coming off Assembly Line

Employment in war industries increased the money incomes of many American families.

Boeing Aircr

$3,000 and over, while in 1939 only 10 per cent received this much. It has also been said that in 1939 from 30 to 40 per cent had incomes of $1,000 or less.

Of course, prices were higher in 1944. For that reason increases in incomes were partly nominal, and not real. But in spite of the increases in prices, it was often said that the American people lived better in 1944 than they did at the beginning of the war. The reason was that there was almost full employment and that wages were high. Many who had never been able to earn more than enough to enable them to live on a subsistence level found themselves with money enough to buy more food and clothing than they had ever been accustomed to.

How Unevenly Is Wealth Distributed? It is well known that wealth, as well as income, is very unevenly distributed. A few persons own millions of dollars worth of property, while millions of others own no property to speak of. But just how great the inequalities of ownership of wealth are, we do not know exactly.

Several years ago the Federal Trade Commission made a study in which it found that 75 per cent of those who die leave so little property that it is not probated or recorded by the government. Of the remaining 25 per cent of those who died, 63 per cent owned only 7 per cent of the number of estates that were probated; 35 per cent owned about 42 per cent; and slightly more than 2 per cent owned nearly 51 per cent of the estates. It is not claimed that these figures show exactly how wealth is distributed among the people. But they help us to understand that relatively few people own most of the wealth.

What Causes Great Inequalities in the Distribution of Income and Wealth? According to the theory of capitalism, where free enterprise and the profit motive in production are allowed to function, the incomes of individuals tend to vary in proportion to their contributions to production. And there are many who feel that the incomes individuals receive and the wealth they own are nearly always deserved. But it is not our purpose here to say what incomes are deserved by those who receive them, or whether wealth is justly distributed.

It is important, however, that we recognize that most businesses are not conducted under purely competitive conditions. It is entirely possible therefore that many incomes do not correspond to the value of the services that the recipients make to production.

Differences in Wages Do Not Explain the Great Inequalities in Income and Wealth. None of the great fortunes in the United States or elsewhere was accumulated from the wages of an individual. Savings from wages may supply the capital with which to start a small business; but they can scarcely be large enough to amount to a great fortune. A few talented individuals may command large salaries for a few years, and be able to live in luxury. Furthermore, they may be able to save several thousands of dollars at the same time. Even so, there is not much likelihood that they could become millionaires unless they found additional ways of making money.

If one were able to save $10,000 a year for forty years, he would have only $400,000 at the end of that time unless he found some way of making his money "grow" as he saved it. You may think that is a lot of money. But it is considerably short of a million dollars. And when we realize that there are some whose incomes are over a million dollars a year and whose wealth is counted in terms of hundreds of millions, a man whose wealth amounts to less than half a million dollars is not rich in comparison.

As for the average individual, there is less probability of his accumulating a fortune from wages. Some years ago it was estimated by the Brookings Institution that nonfarm families with incomes of from $1,000 to $1,500 saved 1 per cent of their incomes. At most, this would be $15 a year. Those with incomes of from $1,500 to $2,000 saved 6 per cent. Families with incomes of $100,000 saved an average of 44 per cent, or $44,000, of their incomes. Of course, few persons receive $100,000 as wages.

Great Fortunes Come Only from Profits and from Inheritances. The names of Astor, Carnegie, Ford, Morgan, Mellon, Guggenheim, du Pont, Rockefeller, Vanderbilt, and others that

could easily be included are almost synonomous with great wealth. Some of the founders of the fortunes associated with these names began life as wage earners. For example, Andrew Carnegie came to this country as a Scotch immigrant boy at the age of thirteen and began work as a very low-paid wage earner. Within a little over fifty years he amassed a fortune of $375,-000,000, but nearly all of it came from profits. Two hundred and twenty-five millions of this amount was invested in 5 per cent bonds, which alone yielded him an annual income of $11,250,000. Most of the stories of the other great American fortunes show how the fortunes, like great oaks, grew from small beginnings.

These fortunes were made in various kinds of businesses. One was made in fur trading, some in iron and steel, some in banking and finance, some in automobiles, some in mining, and others in different kinds of industry and business. But in each case the successful operator of the business managed to escape much of the competition with a great number of others in the same kind of undertaking. John D. Rockefeller, Senior, for example, was able to secure a virtual monopoly in the oil business. Andrew Carnegie built up a company that was so large that he was able to fix the price of steel. J. P. Morgan managed to get control of certain large corporations that he reorganized and sold the new stock so as to make several millions of dollars. About forty years ago Henry Ford obtained a patent for an automobile engine. He had only a few thousand dollars with which to begin manufacturing automobiles. He borrowed a few thousand more and began a business that has turned out tens of millions of cars and other kinds of machinery and that has made the Ford family one of the richest in the world.

The histories of great American enterprises and fortunes leads back to an individual who conceived an idea for a new product or a new way of doing a thing. Frequently the individual was a wage earner. In most cases business was begun under discouraging circumstances, but as time went on, the business prospered, profits were plowed back into the enterprise, and eventually the owners amassed assets worth millions of dollars. Profits, therefore, are the source from which the great American enterprises and fortunes have grown.

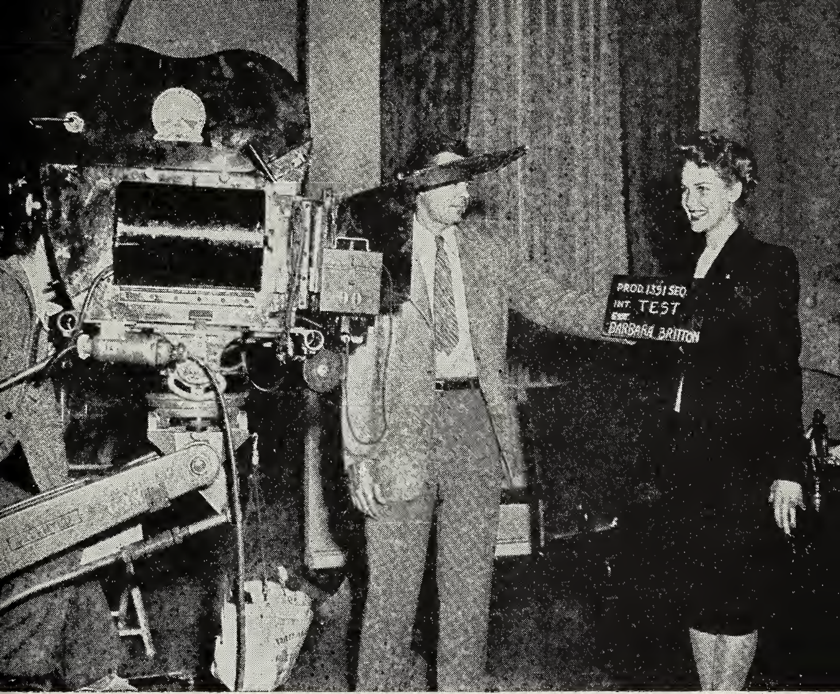
Are There Only "Three Generations from Shirtsleeves to Shirtsleeves"? The idea is accepted by some that if a man works hard and makes a fortune, his children will squander it in luxurious living and poor investments, so that his grandchildren will have to work for a living. There have been some cases where this has happened. But it has never been the rule.

Even if a successful businessman's descendants fail to inherit any of their ancestor's financial ability, it is possible for them to remain wealthy. Banks that do a trust business are prepared to take control and manage the wealth and the investments that wealthy individuals leave to their heirs. A man or a woman may provide in his or her will that an estate shall be held and administered by the trust company, which will pay a certain amount of income to the heirs. It often happens that under the expert management of the trust company, the estate will grow in size. For example, in 1922 William Rockefeller left an estate of $50,000,000 in trust to his great-grandchildren, the estate to be divided among them at the death of their parents. By 1937 the trust company had paid out to the heirs $9,500,000 in income, and the estate had increased to $63,700,000.

Under Capitalism Inequality of Income and Wealth Comes About as a Matter of Course. The reason for adopting and continuing to use our present economic system is the fact that people in general believe that the amount of wealth owned and incomes should not be equal. To some extent at least, it is said the amount of wealth or income that a person owns or receives should depend upon his effort and his merit.

(1) *Differences in Ability.* One of the reasons for the differences in the incomes of the individuals in the various economic groups is that people differ widely in ability. For example, a talented motion-picture actor may earn several million dollars in a lifetime, while most other people could not earn anything at the same kind of work. Of course, were it not for the motion-picture industry, these same actors might not be able to earn a great deal more than anyone else.

These statements do not mean that if a person finds the kind of work for which he is best suited, he can earn a large income. No matter how hard they work or what kinds of work



C. B. De Mille, photo by Bud Fraker

Passing the Screen Test

A few fortunate individuals are endowed with certain qualities that enable them to earn large incomes in particular callings.

they do, some persons cannot make large incomes. For example, a person who is capable only of manual labor finds it difficult to earn a high income because many other people are capable of doing the only kind of work for which he is fitted.

Some individuals seem to have a knack of making money. Their shrewdness or superior intelligence enables them to see opportunities for making money. Moreover, certain people have the ability to stick to an undertaking until they succeed, while many others are lacking in this respect.

(2) *Speculation and Chance.* Speculation and chance often play an important part in the gaining of wealth, from which income may be derived. Few actual gamblers, however, ever accumulate and keep a great deal of wealth. But the man who is shrewd in his calculations, who knows how to act when others are confused, and who takes risks that might frighten other men, sometimes is able to accumulate a great fortune.

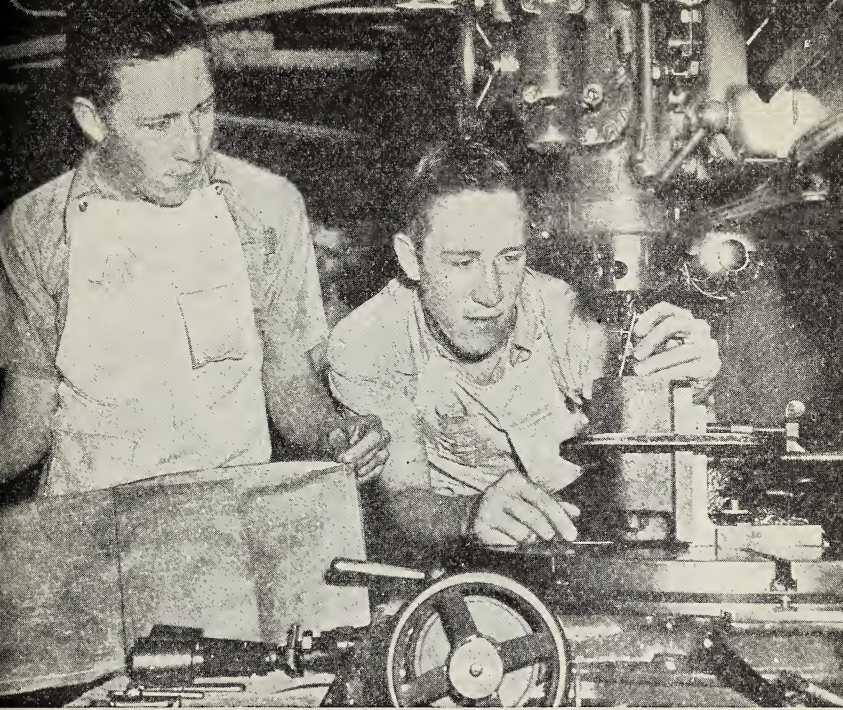
(3) *Inheritance.* Once property has been acquired, it may be transferred by will or gift. For this reason great fortunes tend to remain in certain families. Because of the social prestige that wealth confers, the rich, as a rule, marry the rich, and the moderately well-to-do and the poor tend to marry within their own economic groups. The children of the rich, of course, inherit much of the fortunes of their parents. Furthermore, a person who inherits great wealth need not possess any unusual ability in order to retain his riches and to pass them on to his heirs. His wealth, often in the form of stocks and bonds, may be turned over to a trust company to manage, and he will, therefore, not have to bother with it at all. The trust company will keep the funds properly invested and will look after the income from the principal.

(4) *Questionable Practices.* The ways by which some of the great fortunes in this country and in the world were made, when measured by a high code of ethics, were questionable. By fraud and unfair competition some unscrupulous persons have been able to amass great wealth.

Once an individual has gained a fortune of many millions of dollars, he may acquire social and political prestige. Although he may have employed questionable business practices, he is not regarded in the same way by the public as is the laborer or the small businessman who uses unfair methods in dealing with others. And, when the wealth that has been accumulated is passed on to the next generation, the methods by which it was acquired are forgotten.

(5) *Unemployment and Reduced Wages.* Production in industry does not proceed uniformly. Many fluctuations occur over a period of years. In the ordinary course of events the degree of prosperity of business and industry is constantly changing. For several months, or for a few years, the country may enjoy general prosperity. Good times are followed by times that are not so good, and sometimes by depressions or panic.

When factories and other productive establishments are producing goods in great quantities, wages are usually higher than when there is less production. But even when prosperity is high, some persons seem unable to find employment.



U. S. Office of Education

Vocational Training

The better one's training, the less likely it is that he will be affected by long periods of unemployment.

When a depression in business sets in, wages are reduced and unemployment follows. If the depression is very severe, all wages may be reduced and millions of workers thrown out of employment. Those who retain their positions have to work for reduced pay. The unemployed soon use up what savings they have laid away. Thus the level of living is lowered through no particular fault of the individuals themselves.

The Rules of the Game Are Being Modified. Under capitalism the making of an income and the accumulation of wealth are sometimes looked upon as a game. As in a tennis match or some other athletic game, it is felt that the best player or the one who has the best luck wins. And to some extent the comparison is permissible. For example, the laws that govern the ways by which we may acquire wealth and income are some-

what like the rules of a game. If one buys a typewriter or a pair of shoes and pays for the article, he becomes the owner and can keep and use it. But if he steals a thing, he does not become the owner, and the owner may often recover his goods. Thus there are rules that one must observe in business, just as there are rules in a tennis or a baseball game.

In order to prevent too much of the nation's wealth and also of the national income from coming under the control of too few persons, the rules of business and of wealth-getting have been changed considerably within the last few decades. We have graduated income-tax laws, the rates of which increase faster than the amount of income.

Many states and the Federal Government have death-tax laws. These laws vary, but the general purpose is for the state or the Federal Government, upon the death of the owner, to take part of the estate over a certain amount as an *estate tax*. In some cases the state government can take as much as 16 per cent of a large estate when the estate is left to relatives, and as much as 40 per cent when it is left to nonrelatives. The Federal Government taxes net estates of $60,000 and over upon the death of the owners. The rates of taxation on estates run from 3 per cent on $60,000 to 77 per cent on estates above $10,000,000. If a wealthy person gives away his property before he dies, a *gift tax* must be paid. The gift tax is imposed to prevent wealthy persons from disposing of their property before death in order to evade the estate tax.

The taking of money by government by means of taxation may be used as a means of redistributing wealth. During recent years the Federal Government has borrowed many billions of dollars, some of which has been used to construct public buildings, roads, dams, and other kinds of public works. Much of the money has gone to pay farmers to restrict production and to improve their farms, and great amounts have been used to aid the unemployed and others. Billions of dollars thus expended by the Government were obtained by loans from the people, which will be repaid from taxes. Those who pay the taxes will, in effect, turn over part of their income or wealth to the Government, which, in turn, will repay the money that has been used for public purposes. Much of the spending by

the Government during the 1930's was an example of the redistribution of wealth by government.

In addition to the above method of redistributing wealth and income, the Government exercises various methods and means of control over business. The laws that give government the right to redistribute income and wealth and to control business are rules that people must observe in receiving an income and in accumulating wealth. When the people decide that the rules of the game of business need changing, they simply repeal a law, modify it, or pass another. Naturally those who believe that they would benefit by changing a law are likely to favor the change. For the same reason those who feel that they would lose are more inclined to oppose the change.

There is no doubt but that the rules of the game should be changed as times and conditions change. But changes should be made with caution and not as the result merely of an emotional appeal by some reformer who may not understand or care for the facts that are involved in the problems that he proposes to solve.

QUESTIONS ON THE CHAPTER

1. Is the national income large enough to provide for the needs of all the people in the United States?
2. Why was the national per capita income so much larger in 1942 than it was in 1939?
3. Which sections of the United States have the highest per capita incomes? the lowest?
4. Why is the per capita income of a state not entirely indicative of the prosperity of all the people?
5. What was the average income for consumer units in 1935–36? Was this amount higher or lower than the average for the middle third of the consumer units?
6. How much better did the people in the United States live in the years of World War II as compared with 1935–36?
7. What did the study made by the Federal Trade Commission on estates reveal as to the distribution of wealth?
8. Is the ownership of property indicative of the income of the person?
9. What conditions and factors tend to determine differences in income?

10. Is it necessary for many people in the United States to accept governmental aid in order to live?
11. What actions of the Government tend to prevent too great incomes?
12. What is the meaning of each of the following terms?

    (a) **consumer unit**
    (b) **estate tax**
    (c) **gift tax**
    (d) **per capita income**

APPLICATIONS OF THE CHAPTER

1. In what ways does the inequality in incomes create certain problems and conditions in your community?
2. Report on any recent newspaper item or magazine article that you have read on the subject of the distribution of income.
3. In 1933 and 1934 the Government encouraged either the destruction of part of the crops already planted or the restriction of the acreage to be planted. At the same time the Government found it necessary to support millions of persons to prevent their suffering from lack of food. Discuss the action of the Government. Keep in mind: (1) that the Government was trying to help the farmers; (2) that our exports of farm products had decreased greatly; (3) that help extended both to farmers and to others must be paid for by taxation; (4) the number of farmers; (5) the need for food by all the people; (6) the possibilities of some other plan to relieve the distress of farmers and others. What plan would you suggest? Be definite.
4. (a) It has been said that, as long as they do not violate the laws, individuals must be allowed an opportunity to amass unlimited wealth. It is claimed that to limit the amount of wealth that they might acquire would prevent people of ability from working as hard as they do, and have done in the past, to develop our mines, farms, and factories. What do you think?

   (b) Suppose that no one were allowed to inherit more than $1,000,000. Would great businessmen work as hard as they now do? Why? Do rich men work harder than others? Do they have more ability than others—for example, teachers, lawyers, scientists, painters, and engineers, who, as a rule, do not become rich?
5. It is said that some of the coming-out parties for the debutantes of the very rich cost $50,000 and some of them much more. The expenditures are for such items as flowers, music, decorations, and beverages. Wilkes claims that such expendi-

tures benefit the wage-earning classes because they give many a chance to earn money. Smith says that, if the same amount of money were used to build factories in which people could work at making goods that are needed, money would be spent to the greater advantage of more people. Do you agree with Wilkes or with Smith?

6. It is often said that poverty, crime, and ignorance go together. Are they related? How?
7. People of large fortunes often assert that increases in the taxation of the rich must be borne by the poor and the wage-earning classes. Do they mean that the rich merely collect taxes from the poor and from the wage-earning classes and pay them to the Government? If this is true, why do they complain of high taxes? Do their complaints arise from interest in the welfare of others?
8. It is claimed by some that the profit motive is responsible for the inequality in incomes. What do you think?
9. What are some of the proposals being made by statesmen and politicians to overcome the inequalities in income and wealth? What do you think of the proposals?
10. How does the per capita income in your state compare with the average for the United States and with the per capita incomes of other states? How do you account for the differences?
11. Is per capita income a true indication of the relative welfare of the people in one state as compared with that of the people in other states? What other factors must be considered?
12. Without revealing the identity of individuals and families, how do you account for the differences in the incomes of people you know? To what extent are the differences in income due to differences in effort? to differences in chance? to differences in natural ability?
13. Have there occurred within the last one hundred years any changes in the ways of getting a living that make it desirable for the Government to try to limit the incomes that people receive? Discuss.
14. From the standpoint of the benefits enjoyed, is it cheaper to live in the country than in the city?
15. Discuss in terms of food, housing, clothing, comforts, and luxuries the meaning of poverty, of comfort, and of riches.
16. Is it possible for everyone who is born poor to rise from poverty? Why? If it is, should anyone be concerned with the elimination of poverty or give any study to that matter?
17. How do the conclusions as to the distribution of income in the country compare with the probable conditions in your com-

munity? For example, in 1935-36 about 17 per cent of the poorer families received about 3.5 per cent of the national income, while about 18 per cent of the richer families received about 48 per cent.

TOPICS FOR SPECIAL REPORTS

1. The relation of the size of the incomes of the people to the production carried on in factories and farms.
2. Proposals for the redistribution of the wealth.
3. The causes of poverty.
4. The reasons for huge fortunes.
5. Differences in opportunity due to differences in income and wealth.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Would the limitation of incomes by the Government destroy the ambition and initiative of business leaders?
2. Is a rich class beneficial to all the people in a nation because the examples of luxurious living set by such a class stimulate people in the lower income groups to increase their own incomes?
3. Are the minimum standards for comfortable living indicated in this chapter too high?
4. Is the ownership of wealth and incomes more centralized now than it was one hundred years ago?

CHAPTER 27

LABOR UNIONS AND EMPLOYERS

Patrick McGuire is trying to persuade Sam Halberg to join the union of employees at the plant where they work. "You see, Sam," says Pat, "in union there is strength. We must organize and stick together if we are to get higher wages and a better place to work."

Sam is silent a moment before he answers. "What you say, Pat, is interesting. But I am going to do some more thinking about it before I decide what to do. I'd like to have more wages. And I think the company might make some improvements in the ventilating system and the lighting in the place where we work. Also I wish I could be more certain as to how long my job will last. You say the union can help me to get what I want. Well, that may be. But if I join the union, I'll have to pay dues, work for wages fixed by the company and the union, and maybe go on strike whether I want to or not. Besides the company officials don't like labor unions. I guess I'll think about it some more before I make up my mind."

This imaginary scene illustrates the way many workers feel about labor unions. Before the war about 25 per cent of the wage and salary workers outside of agriculture in the United States belonged to labor unions or worked under some kind of union agreement with their employers. In two industries—the railroads and coal mining—membership of employees in unions was nearly 100 per cent. About 75 per cent of the auto workers and 60 per cent of the steel workers belonged to unions. During the war the number of union members increased. By 1944 it was estimated that union membership in the United States was more than 15,000,000. But in spite of this increase, union membership included only a minority of all wage earners.

What Are the Objects of Labor Unions? The function of a labor union is to enable the members of the union to obtain

certain benefits by means of group or collective action. In other words, the union is used to get for the members certain things that would be more difficult to obtain if the members acted individually.

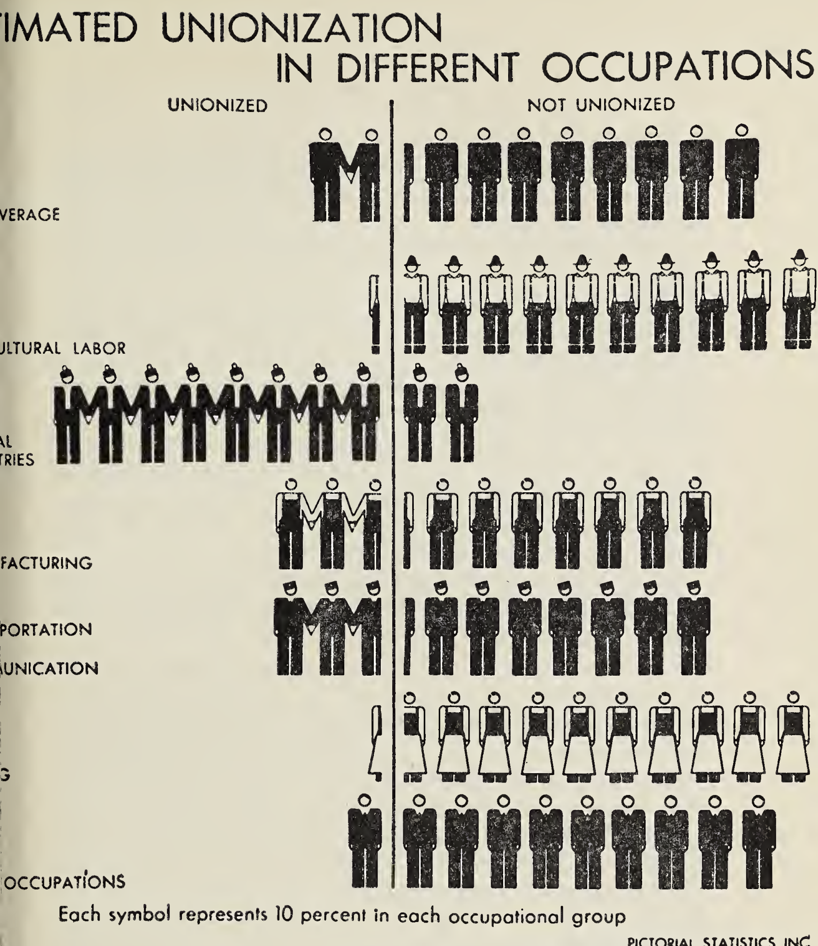
Generally speaking, unions have four objects: (1) the standardization of wages; (2) the raising and the maintenance of wages; (3) the improvement of working conditions; (4) increasing the security of jobs. It is to gain these objects that unions strive to obtain recognition by employers.

Standardization of Wages. An employer will not pay more than is necessary for the services of a worker. Therefore if Smith will not work for less than $5 a day, while Jones will work for $4, assuming that they are equally desirable workers, it is evident that Jones will get the job, and Smith will have to look elsewhere for employment.

Under what we might call normal conditions there are usually more workers than there are jobs. When this is the situation, competition among workers for jobs exists. Those who are willing to work for the least wages tend to find employment first, provided they are satisfactory workers. Others who want higher wages must therefore accept wages that are about as low as those that are paid for those who are willing to work for the lowest possible wages.

Even when there are enough jobs for nearly all who want to work, some workers are willing to accept lower wages than others demand. This fact tends to cause the wages for certain kinds of workers to be lower than they would be if all the workers demanded higher minimum wages.

One of the main objects of unions is to bring about *standard wage rates* for particular types of work. The union endeavors to fix the hourly wage rate and the number of hours that may be worked. This does not mean, however, that the employer is not allowed to pay more than the minimum fixed by the union. Nor does it mean that some workers may not receive more wages because of their superior skill. Standard wages are therefore merely the least wages that employers may pay. The aim of the union in setting up wage standards is to prevent competition among workers for jobs.



Union Membership by Occupations, 1941

One of the advantages claimed for standardized wages is that it stabilizes labor costs to employers in an industry. For example, if all employers in the automobile industry have to pay certain minimum wages for particular kinds of work, each employer knows about what other employers are paying. And he also can estimate pretty accurately what he will have to pay for some time in advance.

Raising and Maintenance of Wages. Has there ever been a strike in your community? If so, it is very probable that it was brought about by a demand by workers for higher pay or in an attempt to prevent a reduction in pay. There are other causes of strikes, but disputes over wages are the most frequent causes.

Labor leaders, as a rule, claim that as time goes on wages should increase. They point out that efficiency in production is constantly increasing. As new methods of production are introduced, the cost of producing a unit of goods decreases. But, it is claimed, producers do not lower selling prices in proportion to the decrease in the cost of production. It is asserted that, as the amount of goods produced increases, the wages of those who make the goods should also increase; otherwise workers cannot raise their scales of living, and manufacturers will be unable to dispose of their products.

Most labor leaders refuse to admit that there is any fixed maximum level of wages, beyond which the amounts that should be paid workers must not go.

In periods of rising prices, as was the case after we entered the war in 1941, labor unions insist on higher wages for their members if for no other reason than to maintain real wages. As the cost of living goes up, it is claimed that the amount of money wages should increase at least in proportion. Otherwise the workers suffer a loss in real wages. When this is the case, what the labor unions demand is the maintenance of the amount of real wages by means of an increase in the money wages. And if the amount of money wages is increased only sufficiently to enable wage earners to buy the same amount of goods as they could before the rise in prices, there is no increase in real wages. Under such circumstances the function of the union is to maintain wages.

When business depressions occur, employers seek to reduce expenses by lowering wages. Workers naturally oppose the efforts to reduce their wages. When this occurs, the aim of labor unions in resisting the efforts of employers to reduce money wages is really to secure an increase in the real wages of the members. For if the cost of living goes down while money wages remain the same as before, real wages increase. For ex-

ample, if Patrick McGuire is receiving $5 a day and the cost of food and other things that he buys falls 20 per cent, he could buy as much as he did before and have $1 left.

Improvement of Working Conditions. Labor unions strive to improve the surroundings in which employees work. Unless factories and offices are properly lighted, the eyes of workers may suffer. If unhealthful fumes and dust accumulate, the health of workers may be impaired. If washrooms are untidy and inconveniently located and if drinking-water facilities are unsanitary, the morale of the employees suffers. And unless adequate safety precautions exist, accidents may result in the injury or the death of workers.

Nearly all the states have laws that require employers to give attention to working conditions in their establishments. Visits are made by state inspectors to see that the minimum requirements set up by the law are being met. In some of the states the standards set by the state laws are much higher than are those in other states. And it is often charged that in some cases inspections are not carefully made.

Increasing the Security of Jobs. Workers want jobs that will last. An employee who is uncertain as to how long he will be employed, cannot be contented. Of course, he understands that if business conditions become poor, workers may be discharged because they are not needed. But workers are sometimes discharged without being given a satisfactory reason. Therefore organized labor seeks general agreements with employers that specify grounds for discharge. Unions also try to establish rules of seniority for workers. When this is done, workers cannot be laid off arbitrarily. If the working force is to be cut, those who have been employed longest are the last to be discharged. And if workers are laid off temporarily, those with the highest seniority rating are rehired first.

Labor unions try to obtain greater security for workers by demanding that only union workers be employed in an establishment. If the employer is free to employ nonunion workers, union employees are in constant danger of being replaced by other workers who are willing to accept jobs at wages lower than those set by the union.

There Are Two Main Kinds of Unions. Two types of labor union have grown up in this country, the trade union and the industrial union.

The Trade Unions. The *trade union* is the older type of labor organization. In some ways it resembles the guilds of the Middle Ages. It is composed of those wage earners who are engaged in doing a particular kind or related kinds of work. Unions of carpenters, bricklayers, painters, tile setters, and cigar makers are examples of trade unions. The purposes of the trade union are to obtain what is claimed to be a fair wage, to limit the length of the working day and the week, to cause the employer to provide what are considered satisfactory working conditions, and, in some instances, to restrict work to those who have met apprenticeship requirements. Some trade unions undertake certain fraternal activites, such as providing aid for unfortunate members.

As early as 1792 the shoemakers of Philadelphia formed a trade union that lasted for about a year. Two years later the shipwrights of New York organized a society of journeymen shipwrights. There were also other less important trade unions about this time.

During the period from 1825 to the Civil War many labor unions of the trade type were formed. Some of these organizations attained considerable strength. The panics of 1837 and 1857, however, had a very discouraging effect upon the unions.

Following the Civil War, there was a marked increase in the growth of manufacturing industries in the United States. As a result, the number of industrial wage earners increased rapidly. Many of the unions organized during this period soon passed out of existance. Others showed vitality and have since grown in importance, and additional unions have been organized.

The Industrial Unions. The other common form of labor union found in this country is the industrial union. The *industrial union* differs from the trade union in that it endeavors to include in its membership all the workers in a given industry, whereas the trade union endeavors to include in its membership those wage earners who are doing a particular kind or related

Mining Coal

Most coal miners are members of an industrial union.

Bureau of Mines

kinds of work. For example, the United Mine Workers of America is intended to embrace all the workers in the mining industry, including teamsters, drillers, electricians, engineers, and other special types of workers. Another important industrial union, the Amalgamated Clothing Workers, aims to embrace all the various kinds of workers in the clothing industry.

What Are the Reasons for the Two Types of Unions? The general objectives of both types of unions are the same. The reason for the two types is a difference in belief as to which method will accomplish the best results. The idea of the trade union is that the organization and the methods of the union will be more efficient and positive if only those of a particular trade are included. On the other hand, those who advocate the industrial union maintain that the united effort of all the workers in an industry toward a common purpose is necessary if the objectives of unionism are to be achieved. In the case of mine workers the isolation of the mines makes it desirable to include all the workers, for in some instances the number of workers engaged in a particular trade in the mine is small.

What Are National Labor Federations? The desire to acquire the benefits from the organization of a large number of workers early led to the formation of local unions into city and state federations. Later, national federations were formed of the various trade and industrial unions.

An attempt at national federation was made in 1869 by the Knights of Labor. Their "first principle" was the protection of

the workers against the "unjust accumulation" of wealth. Their organization was to include all kinds of workers who had been organized into mixed local unions. Because the skilled workers, however, objected to this arrangement, the federation gradually declined in importance, although it had acquired a large membership by 1886.

In 1881 the Federation of Organized Trades and Labor Unions of the United States and Canada was formed under the leadership of Samuel Gompers. It was reorganized in 1886 as the American Federation of Labor (A. F. of L.). The objects of the American Federation of Labor include the confederation of national trade and industrial unions and of other unions not national in their scope. The Federation encourages the organization of local unions and helps to form such unions; it promotes publicity favorable to the cause of labor; it attempts to settle disputes arising over the jurisdictions of trade unions; and it attempts to obtain in the courts what it considers justice for labor.

More specifically it has contended for a shorter working day, the adoption of the shorter working week, and the payment of higher wages. It claims that, if there were more leisure time, the wants of the workers would increase. It is argued that, because of their increased purchasing power from high wages, wage earners would be able to buy more of the products of industry and would thus promote business prosperity.

The Federation has fought consistently for the abolition of child labor and for the limitation of the hours of labor for women. It supports factory legislation designed to provide for the protection of the workers from machinery, for improved lighting and sanitation in factories, and for compensation to injured employees. It also advocates liberal contributions from the state for the support of public education, the creation of a department of education in the National Government, free textbooks, and larger appropriations for public libraries. It advocates the use of a public works program by the Government to provide employment in periods of business depression.

The Federation is not affiliated with any political party. Its policy is to advocate the election of public officials favorable to the objects of organized labor.

Some of the larger trade and industrial unions, including the four railroad brotherhoods and the Amalgamated Clothing Workers, have not found it desirable to join the Federation. These organizations feel that they can accomplish their aims better by working separately.

The A. F. of L. and the C. I. O. As we have stated before, the American Federation of Labor is composed of both trade unions and industrial unions. But it has been charged that in the meetings of the A. F. of L. the trade unions exert the greater influence in fixing the policies of the Federation. Besides, some labor leaders have claimed that the A. F. of L. has never given enough effort to the organization of unskilled workers, particularly in the large, mass-production industries such as the automobile, the meat-packing, and the lumber industries.

In 1935 some of the leaders in the A. F. of L. decided to organize a committee for the purpose of encouraging the formation of industrial unions. The committee took the name of Committee for Industrial Organization, which name was later changed to Congress of Industrial Organizations (C. I. O.). In certain respects this is a federation of industrial unions, just as the A. F. of L. is largely a federation of craft unions.

The leader in the C. I. O. movement was John L. Lewis. As the head of the United Mine Workers he brought strong pressure to bear upon the A. F. of L. and its president, William Green, to meet the demands that more attention be given to organizing workers in industrial unions and that the industrial unions be given a greater voice in the A. F. of L. Mr. Green and his followers contended that the industrial unions had been treated fairly in the A. F. of L. and that his organization had given proper encouragement to the formation of industrial unions.

A bitter dispute developed between the two organizations. The A. F. of L. claimed that this was an attempt to set up a rival organization. It tried to stop the movement, but was unable to do so; and several of the industrial unions were expelled from the A. F. of L. As a result of the fight between the two big federations, both the A. F. of L. and the C. I. O. redoubled their efforts to increase their memberships. Each

organization is active in attempts to establish new locals that will become affiliated with the national federation.

The Future of the A. F. of L. and the C. I. O. It seems unfortunate that organized labor is divided into two great groups. It is unfortunate for labor because, in the pursuit of their legitimate objectives, the various unions are not able to coordinate their efforts and to work in harmony with each other. It is unfortunate for employers because squabbles and disputes between the rival unions sometimes create confusion among employees. And, finally, it is unfortunate for the public because the rivalries between the unions often result in strikes, which bring about decreased production.

Will labor become united? It is impossible to say. Various attempts have been made to reunite the unions into one great federation, but so far the attempts have failed. There are two reasons why the attempts have not been successful. In the first place, the members and the leaders of organized labor do not seem to be able to agree as to which type of union is the better, the trade or the industrial type. In the second place, there is a large element of personal rivalry and jealousy among certain labor leaders.

Some of the friends of industrial unionism have felt that the trade unions will eventually become unimportant. They point to the fact that during the period of nine years from 1935 to 1944 the C. I. O. gained about as many members as did the A. F. of L. during the period from 1886 to 1944, an interval of nearly sixty years. These facts, in their estimation, prove that industrial unionism in the future will gain in importance, while trade unionism will become relatively less important. On the other hand, trade unionists maintain that the strength of organized labor lies in unions that are made up of workers in particular trades. Moreover, the greater aggressiveness of the industrial unions has caused many employers to adopt a more friendly attitude toward trade unions. Whether this fact will influence the growth of the industrial unions cannot be stated.

Organized Labor and Politics. Traditionally, organized labor in the United States has not tried to achieve its objectives by taking an active part in politics. More recently, however,

there have been evidences that the policy of remaining aloof from politics will be abandoned. The actions of the leaders of the C. I. O. especially are indicative of the growing interest of organized labor in politics. In the elections in 1944 the Political Action Committee, an organization sponsored by the C. I. O., was active in an attempt to influence voters to support candidates whose record showed that they were favorable to the interests of labor unions. Whether or not there will be an important national labor party in this country remains to be seen.

Labor Unions Use Many Methods. Labor unions attempt to enforce *collective bargaining* between employees and employers. They contend that the employee is at a disadvantage when bargaining over the wage contract and that for this reason a wage earner can get justice only by the collective action of groups of employees. It is said that the employee, because of the surplus of workers, needs a particular type of work more than the employer needs a particular workman. Hence, if a fair wage is to be obtained, the worker must have the benefit of the support of a group of workers. The members of unions, therefore, claim that the wages for each class of workers in a factory or an industry should be fixed by agreement between the employers and the union.

The Trade Agreement. In the first place, a labor union demands that employers recognize the union as a bargaining agent for the employees. In the second place, after the union has been recognized, it asks for a *trade agreement,* or *labor contract.* This agreement, which is usually written, sets forth the terms under which union workers are to be employed, including wages, hours, working conditions, order in which employees may be discharged, and so on. The agreement may be for a short or a long period of time. Some trade agreements are between the union and only one employer; but others outline the terms and the conditions of employment for a whole industry. In 1944, according to the Bureau of Labor, almost 45 per cent of all workers in private industry were employed under terms of trade agreements. In 1941 only about 30 per cent of the

total number of workers in private industry were covered by such agreements.

The Closed Shop. A *closed shop* is one in which only union members are employed. Formerly it was more often the policy of unions to insist upon a closed-shop contract with employers. Frequently now, however, unions are content with a preferential-shop arrangement, whereby the employer agrees to give preference to workers who are members of the union. Not infrequently as the union becomes stronger, it insists upon a closed-shop agreement with the employer.

The Strike. The strike is a common means of trying to enforce the demands of organized labor. A *strike* occurs when a group of workers, through agreement, quit work as a means of enforcing their demands for increased wages, shorter working hours, better working conditions, or whatever they may desire. Sometimes a strike is called in order to help another group of workers, even though the strikers do not have any grievance of their own. In such a case the strike is a *sympathetic strike.*

A Strike Scene

Strikes sometimes result in acts of violence, involving striking workmen on the one hand and strikebreakers and officers of the law on the other.

Acm

Organized labor contends that a strike is often the only method by which it can control the supply of labor. In reply to the claim of labor that it has the right to strike, the employer maintains that, if the workers quit, he has a right to employ others to take their places. When other employees are hired, the strikers naturally feel resentful because they are then not able to control the supply of labor as they had hoped to, and the success of the strike is thereby threatened. Usually, through the use of pickets placed near the entrance to the factory, the construction job, or other place of work, the strikers attempt to dissuade others from taking their places. Strikers often refer to those who take their places as *scabs*.

Although peaceful argument is usually employed, pickets on some occasions resort to jeers or threats. If verbal persuasion does not avail, pickets sometimes use personal violence. On several notable occasions in the United States, strikers have destroyed property, and many lives have been lost in the bloody conflicts that arose between officers of the law and strike-breakers on the one hand and striking workmen on the other. In nearly all cases in which physical combat has resulted, charges and countercharges as to who was responsible for starting the trouble have been made. And it is seldom possible for the public to know exactly which side was really to blame.

A few years ago an epidemic of *sit-down strikes* occurred in many industrial plants in various parts of the country. Instead of leaving the factories as strikers usually do, the workers simply stopped work at a given time and remained in the factories. They refused to allow others to enter the plants and in some cases barricaded the doors of the buildings. In 1939 the Supreme Court held that the sit-down strike is illegal, and since that time few attempts have been made by strikers to take possession of a factory when they go on a strike.

Early in World War II, labor leaders promised that there would be no strikes in industries devoted to the production of munitions and other essential war materials. In spite of this, however, strikes continued to occur, although they were not called by the leaders of the national labor organizations.

In 1944 Congress passed, over the veto of the President, the National Defense Plants Antistrike Act. This law gave the

President the power to take over plants and mines affected by a strike. It also provided that workers might be ordered back to work at their former wages. Failure to obey the order might bring a fine of $5,000 and one year in prison. Sixty days after production had been resumed in a plant or a mine that had been seized, the business might be returned to the owners. Another feature of the law was that unions were not allowed to make financial contributions to political campaigns for the duration of the war.

The Boycott. In order to coerce employers, wage earners sometimes resort to the use of the *boycott.* When this device is used, workers agree not to buy goods manufactured or sold by employers who are under the ban of the labor union. They also try to persuade other workers not to use the products of the boycotted employer.

The Union Label. The use of the *union label* on goods manufactured by organized labor is encouraged by labor unions. Labor officials endeavor to obtain newspaper publicity favorable to the purposes and aims of labor by advocating the use of the union-made goods.

Limitation of Output. Many labor leaders consider that it is to the worker's advantage to limit output. By limiting output is meant that the worker does not produce all that he is reasonably capable of producing. Those who advocate the deliberate restriction of output feel that there is just so much work to be done and that the worker can make his job last longer, and perhaps increase his wages, if he does not hurry.

From the standpoint of an individual worker and a particular job, there may be some sound reasoning behind the idea that the worker can at least remain employed longer if he "soldiers" on the job. But in the long run, such a policy hurts labor because it results in an increase in the cost of goods and services. And, as we know, an increase in the cost of a good or a service causes a decrease in demand, which, in turn, causes a decrease in the demand for labor that is used in production. For example, if carpenters soldier on the job, so that the cost of building a house is a great deal more than it should be, fewer houses will

be built, and, consequently, fewer carpenters will be employed than if labor costs were less.

Sabotage. *Sabotage* is an extreme method of causing an increase in manufacturing cost that is sometimes used by workers. Out of spite or to produce fear in the employer, workers have been known to damage equipment by breaking machinery, putting water in lubricating oil or sand in the gears. Some persons look upon any method of restricting output as a form of sabotage. Responsible labor leaders do not advocate the willful destruction of property as a means to be used in disputes with employers.

Some Employers Oppose Unions in Many Ways. In order to protect what they consider to be their rights with reference to wage contracts, employers make use of various devices. Individually they attempt to obtain labor at what they consider a just wage. In many instances, however, they have resorted to organization and have adopted certain methods and procedures to combat the aggressiveness of organized labor.

Employers and Business Associations. Employers usually are organized into associations according to the nature of the product that they manufacture or sell. For example, automobile manufacturers, shoe manufacturers, iron and steel manufacturers, owners of drygoods stores and grocery stores, as well as other businessmen, have their own organizations. These organizations, in turn, are sometimes combined into a more or less loose federation or association. In this way employers are able to take collective action with regard to policies, and especially with reference to obtaining favorable publicity.

There are many national associations of the employer groups. The object of these associations is not primarily that of combating the demands of labor. But, at the same time, they do enable employers to establish more or less uniform policies with respect to the treatment of labor.

Black Lists. In their efforts to intimidate labor, some employers have in the past made use of *black lists.* These lists contained the names of employees who had, for one reason or

another, proved unsatisfactory to the previous employers. The lists were sometimes exchanged among employers. While they have been declared illegal, some labor organizations have charged that they are still frequently used.

The Lockout. Another method used by certain employers in their contest with labor is the lockout. By a *lockout* is meant the shutting down of the factory or other place of employment by the employer. Although lockouts are not employed frequently, the threat to close the factory is sometimes used in influencing employees to meet the demands of the employer.

The Company Union. Many large concerns look with considerable favor upon company unions. The *company union* is an organization of the employees in a particular establishment and has no affiliation with any other group of workers. Hence it cannot be easily influenced by national unions or organizations such as the A. F. of L. or the C. I. O.

It is probable that most employers object to any type of employee organization that has strength enough to oppose their policies. The tendency of workers, however, to form a labor organization of some kind or another has resulted in the acceptance by many concerns of the company union as a compromise. The employers believe that the company union will be less likely to create opposition to the regulations set up by them.

In order to combat the growth of trade unions after the passage of the National Recovery Act in 1933, which encouraged labor unions, many large companies strongly helped in the formation of company unions. The growth of trade unions at that time was largely due to the fact that the National Recovery Act aimed to insure workers the right to form unions of whatever kind they wished. After the Act was declared unconstitutional in 1935, the provision relating to labor was amended and included in the National Labor Relations Act.

Through its representative, the company union is able to present suggestions pertaining to the improvement of working conditions. The final action in all matters, however, rests with the employer. Because they claim the employer dominates the company union, the labor unions are bitterly opposed to this type of organization.

"Yellow-Dog Contracts." Formerly it was not unusual for an employer to ask wage earners to sign a contract by which the latter agreed not to join a labor union. Or, if the wage earner was a member of a labor union, he agreed to sever his connection with the labor organization. Such contracts were popularly known in labor circles as *yellow-dog contracts.* They were declared unenforceable by an act of Congress in 1932.

The Injunction. One of the most effective means that the employer has in combating strikes is the injunction. An employer may ask a judge to issue an *injunction,* or order, enjoining strikers from doing certain acts or commanding them to refrain from doing certain acts. For example, an injunction may direct the strikers to refrain from "compelling or inducing by threat, intimidation, persuasion, force, or violence" any employee to quit work. Or the injunction may enjoin anyone from assisting in a strike or a boycott by means of written or spoken words. Under such an order, picketing by strikers and the support of a strike or a boycott might be prevented.

The labor unions have denounced the injunction as being a misuse of the powers of government to aid employers. On the other hand, the employers maintain that strikes and boycotts are designed to injure property and income and that they have a right, under the Constitution of the United States, to ask protection against organized efforts of labor that are intended to harm their businesses.

The Norris-LaGuardia Act, passed by Congress in 1932, is designed to prevent Federal judges from issuing injunctions against strikers when the employers claim that the strikers are conspiring to injure their property. Merely quitting work and urging others to refuse to work is not to be considered as conspiracy. State judges are not affected by the act.

What Are Ways for Settling Labor Disputes? Many questions arising over wages and working conditions are settled by peaceful means.

Conciliation and Voluntary Arbitration. The workers and the employers in a plant or an industry may come together, discuss

Acme P

Conference of Union Leaders, Employers, and Mediation Board

After frank and open discussions, employees and employers arrived at a peaceful solution of a labor question.

their troubles, and arrive at a satisfactory solution. This method of settling disputes is called *conciliation.*

The Federal Government provides a Conciliation Service in the Department of Labor. During recent years the Conciliation Service has handled hundreds of labor disputes each year. A few years ago the National Mediation Board was created by Congress for the purpose of helping to settle disputes between railway employees and their employers.

When the two sides to a controversy are unable to settle the difficulties themselves, an outside individual or a group of individuals may be asked to consider the claims of both sides and to attempt to effect a peaceful solution. If both sides agree to submit their difficulties to an individual or a group and to abide by the decision, the method of settlement is known as *voluntary arbitration.* Some of the states have set up boards to attempt the solution of disputes between wage earners and employers.

Compulsory Arbitration. Some persons and organizations have proposed compulsory arbitration as the best method of settling labor disputes. They contend that there should be a state board of arbitration that would have the right to enforce its decisions in labor disputes. This method would be *compulsory arbitration.* Compulsory arbitration is being tried out in New Zealand and Australia, where it seems to work fairly well. It is possible that the system will continue to be used in these countries, although it is by no means perfectly satisfactory. Compulsory arbitration has been tried to some extent in other countries but without satisfactory results. An attempt was made by the state of Kansas at one time to institute compulsory arbitration, but the effort was unsuccessful.

When strikes occur frequently, and it seems impossible for employees and employers to come to an agreement, people may feel that the Government ought to step in and compel the parties to settle their disputes. But before we decide that compulsory arbitration is the best solution to labor disputes, we should consider the results that might follow the adoption of this plan. In the first place, compulsory arbitration would take from workers the right to strike and some of the rights of private contract. Workers would be compelled to abide by the decisions of the board of arbitration set up by the Government and to accept whatever wages the board might decide was right. It is because of this fact that organized labor has fought the proposal of compulsory arbitration.

In the second place, thus to fix wages or to decide other matters that might be in dispute would interfere to a great extent with the property rights of the owners of business. Therefore the owners of business, as well as the employees, may well fear the adoption of a compulsory method of settling labor disputes. If the employers should find it impossible to pay the wages fixed by the arbitration board, they would be compelled to go out of business. And if great numbers of business concerns should cease to operate, it would become necessary for the Government to take charge of factories and other establishments and to run them. If this should happen, the owners would lose their property, and the workers would have to give up their right to strike and to bargain for wages.

The National Labor Relations Act of 1935. This law is sometimes referred to as the Wagner Act, because it was sponsored by Senator Robert F. Wagner, of New York. The Act is designed to insure to workers the right to organize and to bargain collectively with their employers. The law applies to all employers and employees in establishments whose activities affect interstate commerce. The measure provides for the creation of the *National Labor Relations Board*, consisting of three members appointed by the President and confirmed by the Senate. Under the law employees may join labor organizations without interference from employers, and they may choose representatives for the purpose of collective bargaining. The Board may order an election by secret ballot in order to determine which union in a plant shall be the bargaining unit.

Under the statute, it is unfair for employers

(1) to interfere with, restrain, or coerce employees in connection with their desires to belong to labor organizations.

(2) to discriminate against employees or prospective employees because of union affiliations, except that employers are permitted to enter into open-shop agreements with unions.

(3) to attempt to influence the formation of any labor organization or to contribute to its support.

(4) to refuse to bargain collectively with the duly elected representatives of his employees.

(5) to discharge or to discriminate in any way against an employee for testifying before the Board.

In spite of widely publicized criticisms, the NLRB has been very successful in settling the disputes that have been brought before it. In 1943 the Board closed 86 per cent of the cases brought before it without having to take drastic and extreme action.

During the war, the *War Labor Board* was created by Congress to settle labor disputes that might arise over questions of union security, wages, and other matters, in wartime industries. The NLRB and WLB co-operated in the exchange of information and in the integration of efforts.

Can Labor Disputes Be Settled Peacefully? Under our system of economic order it is to be expected that rivalry should arise over the distribution of the national income. Capitalism takes it for granted that, by the use of proper means, the owners of each of the factors of production will try to obtain as much of the national income as they can. In the case of labor and capital it is assumed that employers will not pay more for wages than labor is worth. On the other hand, it is assumed that workers will try to obtain as much wages as they can. As to whether wage earners will get just wages, it is taken for granted that employees, on the whole, will receive the amount to which they are entitled.

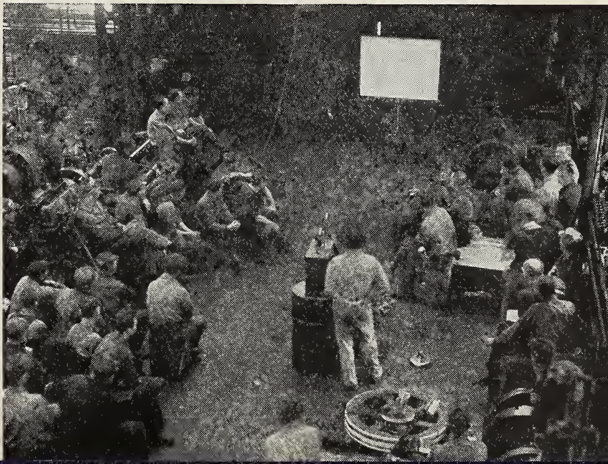
But in fixing the price of wages, in many cases competition does not work perfectly. In some respects the employer is at an advantage in bargaining with the individual employee. Where there is a surplus of workers, the employer may be able to obtain labor at a price that is much lower than the value of the labor. By organizing into unions workers may be able to compel the employer to pay wages that are more nearly equal to the value of the service of the labor. Because of this fact it is sometimes possible for labor unions to enable a worker to obtain a higher wage than he would if he tried to bargain with the employer individually.

It is generally conceded that in many cases labor unions may help the worker to obtain a more nearly just wage. And it is probable that most people agree that union organizations are here to stay. It is not a question of whether we shall have

Safety Education by Means of Sound Films

Many employers seek to improve working conditions and to promote the safety of their employees by means of printed instructions, lectures, and films.

U. S. Steel Corporation



labor unions or not. Rather it is a question of whether collective bargaining in the big industries will result in the peaceful solution of the questions that are bound to arise between employers and employees.

If both employees and employers take the right attitude toward the problems that arise between them, labor unions can be an important factor in promoting industrial peace and prosperity. Members of labor unions, however, should select leaders who are both intelligent and well-meaning and who also appreciate the problems of management. If the leaders are not intelligent, they will be unable to understand the problems of labor, and they cannot tell whether the demands they advocate are reasonable. Unless they are well-meaning, they will use their positions to further their own selfish purposes. And if they do not believe that employees and employers have much in common and that it is possible for them to live and to work together without suspicion, they may be willing to use violent means to effect changes in the economic system.

On the part of the employers there should be a willingness to see that labor unions are natural under the conditions of modern industry. Employers should be willing to concede that everyone has a right to try to protect his own interests by every reasonable means. They should take the attitude that in order to have production, there must be a partnership between labor and capital, and to recognize that, fundamentally, labor has as much at stake in the prosperity of the country as they have. And finally, the owners of capital should not take the attitude that they have the unquestioned right to do as they please without any control from society.

QUESTIONS ON THE CHAPTER

1. What was the estimated union membership in 1944?
2. What are the main objectives of labor unions?
3. Why have different types of labor unions been organized in America?
4. What are the purposes of national federations of labor unions?
5. In what respects does the A. F. of L. differ from the C. I. O.?
6. What are the means used by labor to gain its ends in dealing with capital?
7. What is a "picket" as used by labor organizations?

8. Why were the sit-down strikes judged illegal?
9. What is your opinion of the limitation of output?
10. What are the means of protection against labor organizations that are used by employers?
11. What are the purposes of employers' associations?
12. Why do labor unions oppose the formation of company unions?
13. What dangers would likely accompany compulsory arbitration?
14. What factors would aid in producing peaceful settlement of the disputes between capital and labor?
15. What is the meaning of each of the following terms?

(a) **A. F. of L.**
(b) **black list**
(c) **boycott**
(d) **C. I. O.**
(e) **closed shop**
(f) **collective bargaining**
(g) **company union**
(h) **compulsory arbitration**
(i) **conciliation**
(j) **industrial union**
(k) **injunction**
(l) **labor contract**
(m) **lockout**
(n) **National Labor Relations Board**
(o) **sabotage**
(p) **scab**
(q) **sit-down strike**
(r) **standard wage rates**
(s) **strike**
(t) **sympathetic strike**
(u) **trade agreement**
(v) **trade union**
(w) **union label**
(x) **voluntary arbitration**
(y) **War Labor Board**
(z) **yellow-dog contract**

APPLICATIONS OF THE CHAPTER

1. Report on a current newspaper or magazine article dealing with a labor question.
2. Discuss a local condition involving labor unionism.
3. Do you believe that the controversies between labor and capital arise from the fact that each side feels that it is not getting what justly belongs to it or from the fact that the individuals in each class desire to obtain all the income possible?
4. What are the things that the laborers want? Be specific. Would it be well for the laborers to have the things they want? If they could have them, what effect would this have upon their scale of living, their standard of living, and their outlook on life?
5. Why did not strong national labor unions come into existence until after the War Between the States?
6. What are the relative merits of the two principal kinds of labor organizations?
7. The membership in labor organizations increases during periods of prosperity and falls off in periods of business depression. How do you account for this?

8. Which of the methods employed by organized labor in enforcing its demands are likely to succeed?
9. In your opinion should workers be allowed to strike?
10. In 1933 under the National Industrial Recovery Act, the United States Government insisted that workers should be free to join or not to join labor unions. Many employers in the larger industries were bitterly opposed to the closed shop. Many of them were willing to allow the formation of company unions. What do these facts imply?
11. During a strike are both employers and employees likely to try to gain the sympathy of the public? Why? What methods does each group sometimes use?
12. Does a striker have the right to persuade other workers to refuse to work for an employer with whom he is in a dispute? Suppose the employer's business will suffer if workers are persuaded not to work for him? Is freedom of speech and of assembly involved?
13. What principles are involved in "yellow-dog contracts"?
14. The American Federation of Labor is much opposed to compulsory arbitration. Why should it take this position?
15. Why might an employer object to the compulsory arbitration of labor disputes? Why might he favor it?

TOPICS FOR SPECIAL REPORTS

1. The Wagner Labor Disputes Law.
2. The interest of the public in the controversies between labor and capital.
3. History of the American Federation of Labor.
4. Sympathetic strikes.
5. The interest of labor in politics.
6. History of the C. I. O.
7. Costs of membership in labor unions.
8. National Labor Relations Act.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Have workers lost more than they have gained as a result of strikes?
2. Are strikes unnecessary?
3. Are company unions preferable to industrial or trade unions?
4. Do workers have a better chance to achieve their objectives by means of industrial unions than by trade unions?

CHAPTER 28

ECONOMIC SECURITY

At one time producing goods of any kind was a laborious undertaking. Most of the energy needed was supplied directly by human beings. Moving goods from one place to another was a slow process. And communication with others at a distance depended upon the ability of individuals to carry messages.

Since the beginning of the Industrial Revolution, however, great changes have occurred in methods of agriculture, mining, manufacturing, transportation, and communication. Electrical and steam power now furnish the energy needed to produce most of the goods we use. Railroads, trucks, busses, airplanes, and pipelines provide easy and rapid transportation of many kinds. And the telegraph, telephone, radio, and television make it possible to carry on almost instantaneous communication with people over long distances.

Inventions of many kinds have enormously increased the possibilities of the nation for the production of all the kinds of goods we need. And new inventions and improvements are constantly taking place. Indeed, it seems that the marvels of science and industry will never cease.

But in spite of our wonderful progress in the production of goods, the certainty of jobs and of the economic security of individuals is less than it was in the year 1800. Then most of the population lived on farms, where the problem of unemployment was rather remote. Now most workers are employed in business and industry, and the continuation of jobs depends largely upon events over which they have little control. During periods of prosperity, for various reasons, there are hundreds of thousands of persons who cannot find work. At the depth of the business depression in the 1930's it was said that there were over 15,000,000 unemployed, while a great many were working only part time. Moreover, there is always the possibility that workers will be thrown out of employment because of the in-

Federal Security

Disappointed Job Seekers

During periods of business depression jobs are scarce.

troduction of labor-saving machinery or because of the decline or failure of business concerns.

Thus, while progress in production has been great, the economic security of individuals has decreased. How individuals can gain greater economic security is one of the most pressing problems of our time.

What Is Economic Security? The following quotation is a good statement of the meaning of economic security:

"Security should not be taken to mean a state of affairs in which a man of working age and good health can live comfortably without working. Security properly means a state of affairs in which as a child one will be assured of food, medical care, and educational opportunity; as a worker one will be free from fear and intimidation; and in sickness or old age one can be safe from degradation and despair. For those in the middle, responsible years of life, security means a reasonable chance of

not being hopelessly sunk by the invention of some new manufacturing process or by a sudden shift of foreign trade. Security in this sense is not beyond the reach of the American people, and their eyes are turned toward its attainment."[1]

The Business Cycle Is One Cause of Insecurity. The major cause of economic or social insecurity is the cyclical fluctuations in the prosperity of business and industry. Because of the evil effects that come from changes in the prosperity of the country, many thoughtful persons have tried to find out just what are the underlying causes that produce alternating periods of good times and bad times in the business world. If the real causes could be discovered and understood beforehand, something could be done to bring about more stable conditions of prosperity.

The Types of Changes in Industry and Business. Changes take place in business from day to day. In addition there are other changes that are largely caused by seasonal influences. Then there are still other changes extending over a longer period of time, from several months to several years. Finally, there are changes that extend over several decades.

We may say, therefore, that the following types of changes occur in the conditions of business: (1) *day-by-day;* (2) *seasonal;* (3) *cyclical,* those that last through a period of time from several months to several years; and (4) *secular,* those that extend over many years.

All the changes in business have their effects. But the cyclical changes are of the most importance because they affect the welfare of the people to a greater extent than do the other types of changes.

Business Cycles. The term *business cycle* refers to the alternating waves of good and bad times in business. Alternating periods of prosperity and depression have followed each other in cyclical fashion for a long time, particularly since the Industrial Revolution. Business cycles differ as to length of time and apparently as to the immediate events that cause each

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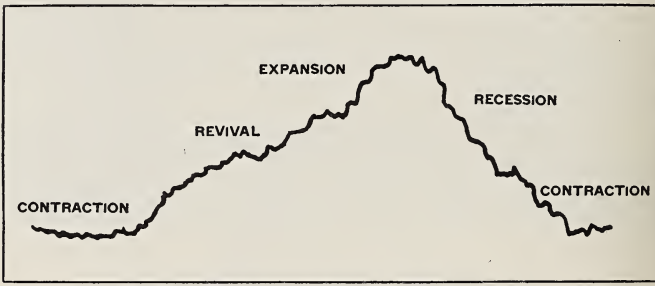
[1]Hoffman, M. David, *Life in America,* p. 211, New York, Harper & Brothers, 1941.

phase of the cycle to appear. But they are alike in one respect: they are all characterized by four phases. These phases consist of periods of revival, expansion, recession, and contraction.

Various theories have been put forth to explain the causes of the ups and downs in business prosperity. Years ago one economist attributed the changes to sun spots. He thought that the sun spots affected agricultural production, which, in turn influenced business in general. Others have stressed the importance of overproduction, politics, psychology, and other factors.



The Phases of a Typical Business Cycle

The irregularities in the general trend of the cycle indicate day-by-day and seasonal changes in business activity.

The Theory of Self-generation. Some economists say that business cycles are self-generating; that is, they claim that business contains within itself the causes that produce alternate periods of good and bad times in the production and marketing of goods.

In the period of *contraction,* wages, interest rates, and the prices of raw materials are low. Goods are scarce, because producers have not thought it worth while to turn out large quantities of goods. After a while some businessmen begin to think that, anyway, it is about time for business to begin to "pick up." Therefore, conditions seem favorable to some increase in business activity.

As production increases, more persons find employment, the demand for raw materials becomes greater, people have more

money to spend for goods, manufacturers and other producers enlarge their plants or build new ones, and times in general become better. This is the period of *revival.*

The gradual acceleration of activity in industry and business creates a feeling of optimism among businessmen. The memories of the period of contraction or depression are partly forgotten. The possibilities of better times in the future calls for new and bigger plans, and the tempo of production and business is stepped up. The prices of commodities rise. Sales increase because of increased purchasing power in the hands of consumers. If there are indications that the good times may not continue always, they do not receive much attention. This is the period of *expansion.*

Eventually, however, the time comes when rising prices do not keep ahead of the increasing costs of labor, capital, and raw materials. As employment becomes more nearly general, the supply of skilled and highly responsible labor decreases. And as less efficient labor is employed and as plants become more fully utilized, the margin between the cost of production and the selling price narrows, and businessmen become more cautious. The rate of expansion slows down, and the desire to get into a good financial condition begins to assert itself. Credit is harder to obtain. As a result of these and other conditions, individual concerns reduce production. When this happens other businesses are affected, and a general decline in prosperity takes place. Sometimes the *recession,* or decline, is gradual; at others it is so rapid that panic ensues, and the rate of business failures becomes terrific. Such, in general, is the way of retreat from the condition of expansion and prosperity. At the end of the retreat lies the valley of contraction, during which time adjustments are made, and the weaker concerns disappear. After a while, the time arrives when the cycle begins all over again.

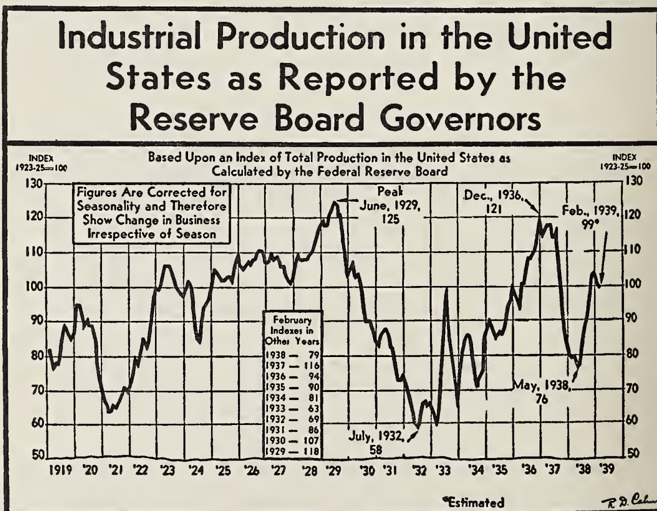
World-wide Business Fluctuations. The great periods of fluctuations in business that have occurred in this country have usually been only a part of similar conditions all over Europe and the rest of the Western Hemisphere. They have not always coincided with the ups and downs in the business of other nations, but they have occurred so nearly at the same time as

to prove that whatever affects business in one part of the world is likely to affect business everywhere.

Can Business Depressions Be Prevented? There are some who contend that it is impossible—and perhaps undesirable—to prevent the ups and downs of business prosperity. They say changes in business prosperity are "just natural," and nothing effective can be done about it.

But most students of the matter agree that it is possible to do something about it. And certainly when we realize the suffering, the privation, and the lost opportunities of many of the youth of the nation that result from depressions, most of us feel that, if possible, something should be done.

Planning by Individual Businesses. Some businessmen claim that it is possible for individual business concerns so to



Chicago Tribune

Prewar Fluctuations in Production

The zigzag line shows the conditions of production from 1919 to 1939. What were some of the results of the ups and downs of business during this time?

plan their businesses as to prevent booms and depressions. It is sometimes said that it is possible for associations of manufacturers and others to gather information as to price trends, the condition of credit, and other matters affecting the future of business, and from this information to plan their operations in such a way as to avoid overexpansion and booms. Likewise, it is claimed that business might be able to predict the time of upswings in business, which would enable business managers to increase production before a revival in business would take place from "natural" causes.

So far, however, there is little evidence to justify a belief that it is possible to say, with any reliable degree of assurance, just how long a phase of the business cycle will last. But even if it were possible, would businessmen be willing to curtail or to reduce production, as the trend might seem to justify, and thus avoid an unsafe peak of prosperity or a distressing slump? Would they agree to act together?

A Program of Public Works. Many advocate a program of government spending upon the construction of public works as a preventive of business depressions. They say that such a program should be prepared in advance, and that at the first sign of a recession in business, public construction should be begun. Those who advocate this plan admit that the billions of dollars spent by the Government from 1933 to 1940 did not succeed in producing full employment and in the restoration of prosperity to the peak attained in 1929. But they claim that the reason lay in the fact that the public-works program was not started until long after the great depression had set in.

The Control of Credit. It has been urged that the main cause of an overexpansion of business is the granting of too much credit to business concerns by banks. Therefore it has been contended that dangerous booms could be prevented by some measure that would cause banks to restrict loans when signs of overexpansion developed. Likewise, it would be possible, it is said, to encourage recovery by adopting more liberal lending policies during periods of depression. Unfortunately for the proponents of this plan, however, our experience in the 1930's did not prove that the manipulation of credit policies

will control business cycles. At best, it is only one of the methods that may be employed.

Laws May Increase Economic Security. According to the theory of *laissez faire,* it is assumed that, if a person works and saves a reasonable part of his earnings, he will be able to accumulate enough property to support himself and his dependents when he becomes incapacitated by age, accident, or illness. According to this doctrine, the necessity for work and for the exercise of thrift will encourage everyone to put forth his best efforts. As a result, it is held, more goods and services will be produced and everyone will be compensated in proportion to his efforts. This theory was generally accepted by American government and business until comparatively recently.

It cannot be denied that everyone who is able should work or at least earn his income in some legitimate way. On the other hand, every person knows that in many instances the individual is the victim of circumstances. Accidents of one kind or another, sickness, unemployment, and the loss of investments often come to people through no fault of their own. On the other hand, many rich persons did not create or accumulate their wealth themselves.

Hence, many feel that some means should be provided to aid those who lose their jobs because of circumstances beyond their control. Unfortunately, few are agreed as how best to provide adequate and appropriate means for this purpose. Every proposal that has been made has been challenged. We shall notice a few of the more important measures that have been proposed in order to protect workers or to make individuals more economically secure. Some of these measures have been enacted into laws by states and some by the Federal Government.

Child Labor. As a rule, *child labor* has been defined as the gainful employment of persons between ten and fifteen years of age. Workers between fifteen and eighteen years of age are often referred to as young persons, rather than as children.

Even before the Industrial Revolution there were children workers. But the coming of the factory system increased the

Bureau of Mines

A Coal-Mine Explosion

The danger of explosions in mines, caused by the accumulation of dust, is only one of the many physical dangers that industrial workers must face.

number of kinds of work that children could perform. Operating many of the types of machines in factories requires comparatively little skill or training. As a rule, the wages necessary to induce children and young persons to work are less than those paid to older workers. In many cases the need to earn additional money with which to aid in supporting themselves and their families influences children and youths to seek work. And in some instances students lose interest in school activities. For these reasons there is a strong tendency for great numbers of children and young persons, who should be in school, to find work in industry unless there are laws that prohibit such employment.

During the last forty or fifty years there has been a growing sentiment on the part of the public against the regular employment of children and young persons. As a result, laws have been enacted to discourage the practice. An idea of the decrease

in the number of children and young persons employed in industry since 1900 is indicated by the following table:

PER CENT OF CHILDREN AND YOUNG PERSONS GAINFULLY EMPLOYED
1900–1940

Years of Age	Year				
	1900	1910	1920	1930	1940
14–15	30.9	30.7	17.5	9.2	5.2
16–17	54.2	59.4	44.7	31.7	21.0

Now practically every state has some kind of a law regulating child labor. Unfortunately, it is often charged, these laws are not always very rigidly enforced.

Common features of the laws of some of the states are: (1) a minimum-age limit, usually fourteen, under which employment for wages is prohibited; (2) the prohibition of work in dangerous occupations for children sixteen to eighteen years of age; (3) a maximum number of hours per day or week; (4) the prohibition of night work; and (5) the necessity for attending school during part of the time. In some of the states the standards are not so high as these. Most of such regulations are not intended to apply to agriculture.

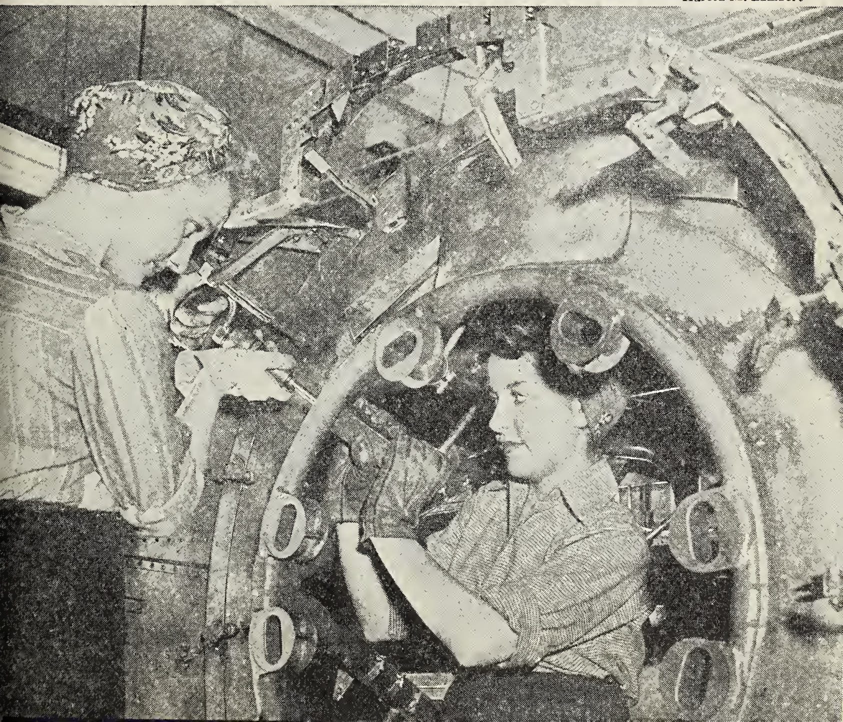
The Federal Fair Labor Standards Act attempts to discourage the employment of children and young persons in industry other than that of agriculture. This law prohibits the employment of persons under sixteen in industries engaged in interstate commerce, except when the person is employed by his or her own parents in an occupation other than manufacturing or mining. It also prohibits the employment of persons between sixteen and eighteen in occupations that are considered detrimental to health by the Children's Bureau of the Department of Labor.

During World War II, owing to a scarcity of labor, the number of children and young persons engaged in industry and business greatly increased. In many cases the enforcement of child-labor laws was relaxed.

The Regulation of the Labor of Women. The Supreme Court of the United States has ruled that the labor of women may be regulated by law. In 1935 forty-four states and the District of Columbia had laws regulating the employment of women. These laws deal with such matters as hours of labor, restricted occupations, and working conditions. State regulations on this matter vary widely. In general, however, there seems to be an effort to exclude women from employment that will undermine health and morals. Recently there has been a movement among the states to enact minimum-wage laws that will encourage the payment of wages high enough to enable women employees to support themselves properly. The subject of laws relating to the labor of women is of great importance because the number of women gainfully employed is increasing.

Young Women Workers in an Airplane Factory
Women can fill successfully many of the jobs found in the modern factory.

Harold M. Lambert



Should the Wages of Men and Women Be Equal? Usually, but not always, the total wages paid women are lower than those paid men. This is often true even when wages or salaries are paid by the month or the year. In some cases the piece rates for women are lower than for men. And in many places the salaries of women teachers are lower than those for men teachers, although in an increasing number of cases salary schedules are being fixed without reference to sex.

There have been several causes as to why the wages for women have been lower than those for men. It is said that women as individuals are weaker than men when bargaining for wages. It is only recently that women have taken an active part in labor unions. Another disadvantage to most women is the fact that they are less willing than men to move from one place to another, so that they tend to accept whatever wages they can obtain in the neighborhood where they live. Finally, many women are willing to accept part-time or temporary employment in order to earn a little extra money or to help out with the family finances. Many young women take jobs with the expectation of getting married after a short time, which may cause them to accept rather low wages.

Most labor-union organizations take the position that there should be "equal pay for equal work." This, in general, is also the position of the Federal Government. On the other hand, those who justify unequal pay for men and women claim that many women have merely themselves to support, and that many do not have the responsibility of supporting a family. It is often said that women are not as efficient as men. And, finally, there are those who maintain that "woman's place is in the home."

Perhaps the whole question cannot be solved by discussions of the relative general efficiency of men and women workers. Men can do some kinds of work better than women; and women can do other kinds of work better than men. And in some cases their efficiency is about equal.

The Regulation of the Labor of Men. For many years the right of government to regulate the hours and the working conditions of men has been recognized. But the question of just

how far government can go in the exercise of this power is a problem. Except to a limited extent the Federal Government cannot regulate labor in the states. That right is reserved to the state legislatures. Only in the case of its own employees, governmental contracts, and of workers engaged in producing goods or services for interstate commerce can the Federal Government regulate the working hours and other conditions of employment.

In 1907 the number of hours per day for persons engaged in railway transportation was fixed at sixteen. In 1916 the number was reduced to eight by the passage of the Adamson Act.

Nearly all the states have laws for the regulation of the labor of men. There is, however, so much diversity among the laws of the various states that we cannot enter upon a discussion of the provisions of the laws.

The Shorter Working Day. By means of improved machinery the labor of the worker is much more effective now than it was even a few years ago. It is, therefore, possible to produce more goods with less labor than formerly. Hence, it is often argued that everyone should have more leisure. At the same time, there are many persons who find it difficult to obtain enough food and other necessities of life. Some workers are willing to work ten or twelve hours a day, and some employers insist that there should be few, if any, restrictions on the number of hours that employees may work.

In view of these facts some labor unions contend that the number of working hours a week in manufacturing and some other pursuits should be limited to thirty. It is said that such a law would give the individual more time to enjoy life, to take an interest in social and political affairs, and in general, to acquire more culture. Moreover, it is pointed out that he would want more kinds of goods and services and that this increase in his wants would create a larger demand for labor and the products of industry. It is contended that if labor is given full employment and capital is kept in regular production, it would be possible to produce all the goods the people need on the basis of a thirty-hour week. The result, it is claimed, would produce greater profits and more regular employment.

Those who oppose the thirty-hour week contend that such a reduction in working hours would make impossible the production of enough goods to supply the needs of the people. And, they say, since wages would be correspondingly higher, prices would be higher and profits would be more difficult to make.

The Wages and Hours Act of 1938. In some respects this is the most important law dealing with labor and wages ever passed by Congress. The law applies to employees who are engaged in manufacturing, mining, transporting, handling, or in any way having anything to do with goods or services that move in interstate commerce. It has been estimated that the law affects more than 13 millions of workers.

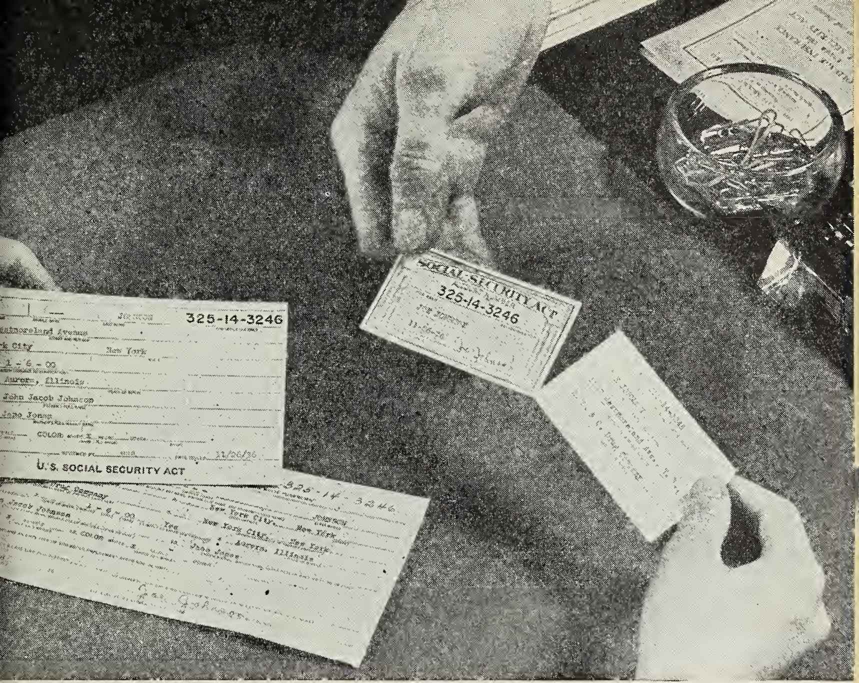
The Act fixes the standard work week at forty hours. The minimum wage is 40 cents per hour, although there are some exceptions.

As we said before in this chapter, the law attempts to lessen the amount of child labor. No distinction, however, is made between the labor of men and women.

Workmen's Compensation. Under laws in various states, employers of more than a certain number of persons are liable for most accidents to their workers. Injured workmen are entitled to compensation for injuries resulting from accidents that incapacitate them. In some states all employers contribute to a state insurance fund, from which benefits are paid to workers who suffer accidental injury that prevents them from working. In other states employers are allowed to carry insurance with private companies for the protection of their employees.

Here, again, there is great variety as to the benefits that workers may receive under the laws. In some states the amount of compensation that the employee may obtain is perhaps adequate, while in others it is very small.

The Social Security Act. In 1935 the Social Security Act was passed by Congress and became a law. The Act contained three main provisions, as follows: (1) unemployment compensation for certain classes of workers; (2) old-age benefits for selected classes; (3) Federal aid for needy aged, needy blind,



Social Security Board

Social Security Forms

Individuals affected by the old-age and survivors' insurance provisions of the Social Security Act must apply for a social security number and card.

and children who lack parental support, for maternal and child health services, for medical care for crippled children, and certain provisions for aid to states in maintaining welfare work.

Unemployment Insurance. The reasons for unemployment insurance are many. In the first place, when business depressions occur, employees are often thrown out of work. As a result, widespread suffering may follow. Moreover, industry and trade cannot make profits because of the decreased purchasing power of the unemployed.

Men and women are also often dispossessed of their work by the introduction of labor-saving machines. If the employee who thus loses his position has become highly specialized in his training, he may find it difficult to obtain employment, even in good times. If a person is getting on in years, or if times are not good, he will likely find it necessary to take, at a much lower wage, work for which he is not suited.

The object of the unemployment insurance provision of the Social Security Law was to encourage the states to set up unemployment insurance systems. It was not to provide for a national system of insurance. In order to induce the states to provide insurance for unemployment, the law specifies that most employers of eight or more persons must pay a tax of 3 per cent to the Federal Government on the wages of each employee up to $3,000 a year, unless the state in which the employer's business is located has an insurance system acceptable to the Federal Government. In case the unemployment insurance system of the state is satisfactory to the Federal Government, the employer may pay 90 per cent of his unemployment insurance tax into the state fund and the remaining 10 per cent to the Federal Government.

Since employers are compelled to pay the tax, regardless of whether their state has unemployment insurance or not, all the states have enacted unemployment insurance laws of their own.

The provisions of the law for unemployment and old-age and survivors' insurance do not cover all gainfully employed persons. The following classifications of workers were excluded from the benefits of the law: agricultural laborers; domestic employees; family workers; employees of the government; and employees of certain types of institutions, including hospitals, schools, and colleges, that are not operated for profit. A special law, the Railroad Retirement Act, provides benefits for retired railroad employees.

Old-Age and Survivors' Insurance. The Social Security Act provides compulsory retirement and survivors' insurance for employees covered by the law. Under the law employees may retire at the age of 65 and receive the monthly benefits to which they are entitled. The amount of monthly benefits to which a worker is entitled when he retires depends upon (1) the amount of his monthly earnings, (2) the length of time he has worked, and (3) his family status. Upon the worker's retirement, benefits are also available for his wife, if or when she is 65 years old, and for his children until they are 16 years old or until they are 18, if still in school.

When a qualified worker dies, survivors' payments are provided for (1) his children until they reach 16, or 18 if still in

Social Security Board

Retirement Benefits

A retired worker and his wife receive a check for their monthly retirement benefits.

school; (2) his widow while she has such children in her care; (3) his widow, if or when she is 65; (4) his dependent parents at age 65, if he has no widow or young children.

When the worker leaves no survivor entitled to monthly payments at the time of his death, lump-sum death payments are made. These may go to the widow, widower, child, grandchild, or parent, in the order named. If the worker is not survived by any such relative, the lump sum may be paid to either relatives or friends who paid the burial expense.

The table at the top of page 470 shows examples of possible amounts of benefit payments under the Social Security Act.

Old-Age Assistance. Many aged persons cannot qualify for old-age insurance under the Social Security Law. At the time the law was passed, some were past 65, others under that age were unable to hold a job, and many others were not in occupations covered by the act. A great number of such persons,

EXAMPLES OF OLD-AGE AND SURVIVORS' MONTHLY BENEFITS UNDER THE SOCIAL SECURITY LAW

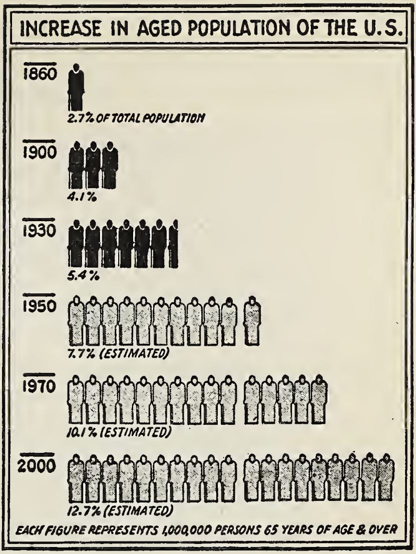
Average Monthly Earnings	Single Person or Married with Wife Under 65	Married with Wife Over 65 or Wife Under 65 and 1 Child Under 18 in School
	AFTER WORKING 10 YEARS	
$ 50	$22.00	$33.00
100	27.50	41.25
150	33.00	49.50
200	38.50	57.75
250	44.00	66.00
	AFTER WORKING 20 YEARS	
$ 50	$24.00	$36.00
100	30.00	45.00
150	36.00	54.00
200	42.00	63.00
250	48.00	72.00
	AFTER WORKING 40 YEARS	
$ 50	$28.00	$42.00
100	35.00	52.50
150	42.00	63.00
200	49.00	73.50
250	56.00	84.00

however, were and still are in need of financial assistance. Therefore, in order to stimulate state legislation to aid the aged needy who could not receive benefits under the old-age and survivors' insurance provision of the law, the Social Security Act provides a Federal subsidy to the states for aid to old people who are without adequate means of support.

Under the law the Federal Government matches on a 50-50 basis benefits paid to such persons, provided the amount is not more than $20 a month. That is to say, the Federal Government will contribute any amount up to $20 a month for the aid of a needy individual if the state will pay an equal amount. There is no limit on the amount the state may pay. The monthly amounts paid individuals in the different states vary

greatly, the range being from a little more than $9 in some of the southern states to more than $40 in Colorado. In 1943 the average was $24.67, and the number of persons receiving assistance was about 2,170,000.

Other Provisions of the Social Security Act. The Social Security Act also provides assistance to the blind, to dependent children, to mothers in need, and to crippled children. Such aid is in the form of subsidies to the states and is designed to encourage the states to expand their public welfare programs. The Act also provides for an extension of Federal aid to the states for the purpose of increasing local and state public health services.



New York Times

Proposed Extension of Social Security Benefits. A small minority are opposed to the principle of social insurance. Many people are fairly well satisfied with the law as it stands. Others, however, say that it should be changed in one or more ways.

In this connection it is interesting to read the opinion expressed in a statement issued by the National Planning Association in 1944. Among other things it was asserted in this statement that:[1]

The provisions of the present Social Security laws are, however, far from adequate . . .

Old-Age and Survivors' Insurance—Benefits of the present old-age and survivors' insurance program should be increased, and the coverage should be extended to include employees of nonprofit corporations, agricultural and domestic workers, and

[1]*Joint Statement on Social Security by Agriculture, Business, and Labor*, Planning Pamphlet No. 33, April, 1944, National Planning Association, Washington, D. C. (This organization is a voluntary association made up of leaders from "varied fields of government, business, labor, the sciences, and the professions." Its main objective "is, by foresight and co-ordinated use of existing knowledge, to study and recommend for consideration plans for coping with the future.")

the self-employed, as well as owners of business. As soon as practicable we should like to see the entire population covered by a system which will entitle everyone to a certain minimum benefit in old age . . .

Sickness and Disability Insurance—Income losses due to sickness and disability should be provided by social insurance. This can be done by setting up a disability insurance program covering the gainfully employed population, including agricultural workers and the self-employed.

Unemployment Insurance—The present unemployment insurance system should be amended so as to provide, after a waiting period of one week, for payment of normal benefits for 26 weeks of involuntary unemployment . . .

Public Assistance—The State or locally administered general public assistance programs . . . should be strengthened and made more adequate by the provision of a Federal Grant-in-aid to be distributed among the states . . .

Social Security Administration—The old-age and survivors', unemployment, and temporary and permanent disability insurance programs should be organized on a national basis and operated by the National Government. The public assistance programs, both special and general, should continue to be operated by the states and localities . . .

Social Security for Ex-Service Men and Women—Steps should be taken immediately to protect the security of ex-service men and women . . .

Medical care, including facilities for hospitalization and rehabilitation, must be made available to all our people . . . A practical method of overcoming the financial limitations to the purchase of adequate medical care . . . would be to make this provision through social insurance . . . There is no reason why such a program when carefully devised should interfere with the freedom of the patient to choose his doctor, or of the doctor to choose his patients . . .

Industrial Insurance. A few industrial concerns have provisions for pensioning employees who have been in their service a specified number of years. There are two reasons why private concerns may provide retirement pensions for employees. One reason is that the prospect of a pension may encourage loyalty of workers and may help to prevent labor trouble. The other reason may be that an employer may feel that employees are really entitled to the additional security that a pension affords.

Employment at Reasonable Wages Is the Best Insurance Against Insecurity. Want and privation come to people when they are unable to obtain the goods and the services they need. As long as they are able to work and are able to find continuous employment at reasonable wages, they can take care of themselves and their dependents. It is when they become unable to work, or when their incomes from wages or other sources are reduced, that they become needy. Obviously the great needs of the working man are health and a job that pays fair wages.

What is needed most to provide regular jobs is the prevention of business depressions. Idleness causes poverty to the unemployed and reduces the well-being of all. It has been estimated that unemployment during the 1930's was responsible for the loss of $200,000,000,000 of income in the United States.

The cause for unemployment is not that there is no need for work. As has so well been said, "There is plenty of work to do. We need improved manufacturing equipment to produce more and better goods at lower prices. We need to carry on extensive research in the laboratories of our great private corporations, in our universities, and in government bureaus to create new products and to develop new processes. We need to rehabilitate and modernize our transportation system—by land, water, and air. We need continued advance in the techniques of production, distribution, and transportation—in short, in all those elements that enter into a higher standard of living. We need to rebuild America—urban redevelopment projects, rural rehabilitation, low-cost housing, express highways, terminal facilities, electrification, flood control, reforestation. Many public developmental projects open fresh outlets for private investment. We need a public health program, including expansion of hospital facilities. We need a nutrition program. We need more adequate provisions for old age. We need higher educational standards in large sections of the country. We need a program to improve and extend our cultural and recreational facilities. We need enrichment of the material and the spiritual resources of our American way of life. We have seen how it is possible to mobilize the productive

capacities of the country for war. We can also mobilize them for peace. Under a program of full employment new enterprises would grow up; old enterprises would expand. Youth would quite readily find opportunity and employment."[1]

The statements in the above quotation are only another way of saying that there is much work to be done before all the people can enjoy a high scale of living. And if a way could be found for getting the work done, the problem of unemployment would be solved.

Does Government Have a Responsibility for Employment? Before the great business depression of the 1930's, a majority of the people did not think that government should take any large-scale, positive action to relieve unemployment. But beginning with 1933, under the guidance of the "New Deal," the Federal Government undertook production projects, such as the TVA; set up agencies to aid in financing railroads, low-priced housing developments, farm co-operative marketing organizations, banks, public works of many kinds; adopted a comprehensive program to aid and to control agricultural production; extended aid to students in high school and college; distributed funds to aid the aged needy and physically handicapped persons; and did other things in order to try to increase employment and to provide purchasing power for those without jobs or money. Whether the Government was justified in undertaking to carry out the "New Deal" plans is a question that is vigorously debated.

Some economists and political scientists hold that it is definitely the responsibility of the Government to pursue a policy that will prevent widespread and prolonged unemployment. They contend that there are many kinds of services that the people need that will not or cannot be provided by private enterprise. Therefore, it is claimed, it should be the policy of government to provide these services and to pay for them out of income received for some of the services and from taxes. The kinds of undertakings suggested include: the clearance of slum districts and the erection of low-rent houses, parking

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[1] *Economic Planning for Full Employment*, Problems in American Life: Unit No. 10, National Council for Social Studies, 1942.

spaces for motor vehicles, parks and recreational facilities, improvement of rivers and harbors, flood control, development of hydro-electric power, irrigation, drainage, soil conservation projects, interregional highways, bridges, airports, hangars, beacon lights, rural electrification, rural housing, reforestation, hospitals, prisons, school buildings, research stations and laboratories, government buildings, and others.

To do all these things would, of course, cost a great deal of money. But, it is claimed, such widespread building projects would result in almost full employment and a high degree of prosperity for private business. Most of those who advocate such a program insist that the free enterprise system should remain, and that government should give its attention to providing those services that private business finds it unprofitable to undertake. They argue that full and continuous employment would mean a greatly increased national income, so that the cost of the government undertakings could easily be met by means of taxes.

There are some who say that because of the huge national debt it is impossible to finance any new government undertakings. There are others, however, who say that it is not necessary ever to pay the national debt. They point out the fact that England still has not paid all of her national debt that was incurred in the Napoleonic wars. It would be desirable, it is claimed, to allow bondholders to continue to hold their bonds and for the Government to pay the interest. If a bondholder desired to do so, he could sell his bonds, without any loss, because they would represent the safest investment that one could buy. For that reason the market price of the bonds would not fall. With full employment and a large national income, the payment of the interest would not be burdensome on taxpayers.

The Problem of Providing Full Employment Is Not Easy. How to make it possible for everyone to have a job and to retain our accustomed way of life is a difficult problem. Of course, if government took over all industry and business, it could provide jobs for all. But many individuals would lose much of their accustomed freedom, and they would probably

feel that the price for economic security by this means would be too high.

The problem would be difficult enough if we had to consider only the factors that are involved here in the United States. But in the final solution attention will have to be given to business conditions and employment in other nations. For our economic relations with other nations are becoming more complex and more important as time goes on. The conditions that exist in the other nations affect us also. You will probably agree that here is a matter that invites the attention of all intelligent persons.

QUESTIONS ON THE CHAPTER

1. Why has progress in the science of making goods not resulted in economic security for the individual?
2. What is economic security?
3. What are the types of changes in industry and business?
4. What theories have been advanced to explain the causes of the business cycle?
5. What is the theory of self-generation?
6. What three methods have been suggested for preventing depressions?
7. What are some of the common features of the child-labor laws of some of the states?
8. Why are women usually paid less than men?
9. Why cannot Congress pass laws regulating the labor of men in all fields?
10. What changes in the hours men work have taken place in the past forty years?
11. To what extent should an employer be responsible for accidents to his employees?
12. Why is unemployment insurance becoming increasingly important?
13. What are the three main provisions of the Social Security Act?
14. To what extent does the Social Security Act function through the states?
15. How does old-age insurance differ from old-age assistance?
16. What do you consider the most important reason for old-age insurance?
17. What recommendations have been made for changing the Social Security Law?
18. What is said as to the responsibility of the Government for preventing unemployment?

19. What is the meaning of each of the following terms?

(a) **business cycle**
(b) **child labor**
(c) **contraction**
(d) **cyclical changes**
(e) **expansion**
(f) **industrial insurance**
(g) **recession**
(h) **revival**
(i) **seasonal changes**
(j) **secular changes**
(k) **Social Security Act**
(l) **unemployment insurance**
(m) **Wages and Hours Act**
(n) **workmen's compensation**

APPLICATIONS OF THE CHAPTER

1. Report on a newspaper item or a magazine article dealing with present-day and former ways of living, the insecurity of the individual in our economic society, the business cycle, or social legislation.
2. Bowie says that he is opposed to all social legislation because when such legislation is undertaken, there is no telling where the lawmakers will stop. Horton contends that Bowie's contention is unreasonable. What may be said in justification of the contention of each?
3. Some individuals maintain that all social legislation should be left to the states, while others say that social legislation should, for the most part, be undertaken by the National Government. What is your opinion? Why?
4. Suppose that one state adopts a minimum-wage law. What effect will the law likely have on the manufacturers who sell goods in competition with manufacturers in those states that do not have minimum-wage laws? Is your answer an argument for or against national laws that pertain to the regulation of business and industry?
5. Even if business depressions could be eliminated, would there still be need for laws relating to old-age insurance, workmen's compensation, unemployment insurance, mothers' pensions, and other types of social legislation? Give reasons for your answer.
6. It has been stated that private insurance against the results of illness, old age, industrial accidents, and unemployment is impossible for the masses of the people because of the low incomes of these people even under prosperous conditions. Discuss the statement.
7. How should funds for old-age pensions, unemployment insurance, and expenditures for similar purposes be obtained? Should they be contributed by those who will be likely to benefit directly? Should they be supplied by employers? Should both employers and employees contribute? Should

the funds be raised by general taxation? Should more than one method of raising the funds be used? Discuss fully.

8. Discuss recent legislation dealing with social insurance.
9. Should old-age insurance be only for the poor and needy, or should it be for everyone?

TOPICS FOR SPECIAL REPORTS

1. The ways in which life is different from what it was in 1850; in 1900.
2. The Social Security Act.
3. Proposals of the National Government for regulating child labor.
4. Arguments for and against unemployment insurance.
5. The reconversion of industry following the war.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Because of old-age pensions or insurance will most people not work hard and be less thrifty than they would be if there were no such pensions or insurance?
2. Should old-age pensions or insurance be left entirely to the states?
3. If the business cycle could be abolished, could poverty be eliminated?
4. Should the Government attempt to keep the size of occupational groups regulated according to the need for workers?

CHAPTER 29

CAPITALISM, SOCIALISM, COMMUNISM, AND FASCISM

The average American takes capitalism for granted. Sometimes he may think that wealth and income are not always justly distributed. And when he sees some people living in luxury and enjoying leisure, while others are unable to afford the common necessities of life although they work hard, he may feel that something is wrong somewhere. But he is not likely to consider taking any drastic action to change the situation. In other words, the average American is a conservative with respect to his attitude toward the economic system.

The majority of American workingmen, as well as those in the professions and those who own or manage business enterprises, seldom raise the question as to whether factories, banks, and stores should be owned by private individuals and corporations or by government. They simply assume that most businesses should be—and will continue to be—owned as private property. They expect manufacturers and merchants to make a profit when they sell goods. They have a feeling that the United States is the richest nation on earth, and that the wealth that is here was produced and accumulated as a result of "the American way of life." Therefore, while they may worry at times over the possibility of losing their jobs or may be unable to see how they can greatly improve their scale of living, they are likely to conclude that there is not much they can do about it. They are not inclined to look with favor on any proposal that would mean a radical change from the customary ways of making a living.

At the same time, we sometimes hear individuals express concern as to the future of "the American way of life." It is often said that the "radicals" would like to overthrow capitalism and get control of the government. In political campaigns and in legislative bodies one hears the terms "socialism," "com-

munism," "totalitarianism," "Nazism," and "Fascism" hurled back and forth by those who oppose and those who favor certain kinds of laws.

What do these terms mean?

Socialism Means Government Ownership of Most Capital. While socialists differ among themselves as to the details of carrying out their ideas, they all contend that:

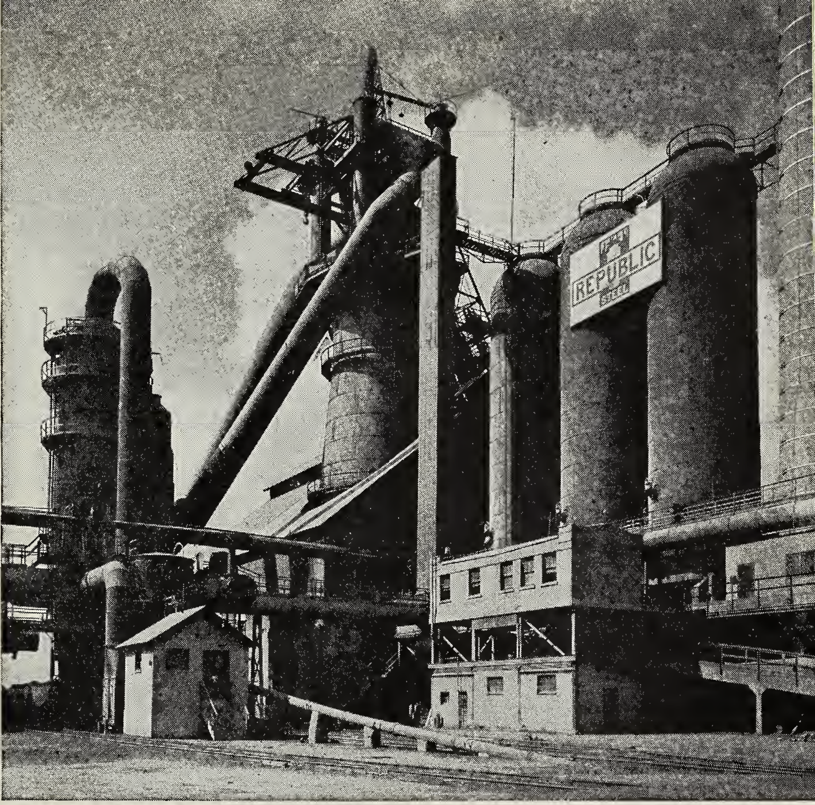
1. Productive wealth—factories, stores, mines, telephone and telegraph lines and equipment, transportation facilities, electric power, banks, most of the land, and other forms of productive property—should be owned by the state, that is, by the government; and government should be the only employer in the major types of business and industry.
2. Competition in industry should be abolished.
3. Production for use should be substituted for production for profit as the motive in production.

The Charges of Socialists Against Capitalism. Socialism maintains that the private ownership of capital and the operation of business for profit results in many evils. We can sum up the various charges of socialism against capitalism in a series of brief statements. Socialists claim that:

(1) The private ownership of capital results in great differences in wealth and income. Because of this, some are able to obtain more than their fair share of the national income, while others receive too little.

(2) The wrong goods and services are produced. Under capitalism, production for profit is the motive. It is often more profitable for manufacturers to use capital for the production of luxuries that can be bought only by the rich than it is to produce goods that are needed by the many.

(3) Competition in the manufacture and sale of goods and services is wasteful. There are more filling stations, grocery stores, and other kinds of business establishments than are needed. Advertising, the cost of which must be added to the selling price, also is wasteful.



A Large Blast Furnace
Under capitalism most industrial plants are owned by private corporations and individuals; under socialism they are owned by the government.

(4) Competition wastes and destroys natural and human resources. In order to "get rich quick," wasteful methods of production have been used in developing our oil, gas, coal, and timber lands. Under capitalism much of our agricultural land has been worn out or has washed away. The desire of employers to make profits results in overworking and underpaying labor.

(5) Co-operation instead of competition should be the rule. There would be less waste and strife among the people if competition were abolished.

(6) Competition in production results in periods of general prosperity followed by periods of business depression. Besides the changes in business conditions that make up the business

cycle, there are seasonal changes that produce unemployment and low wages. All of these changes could be prevented if production were controlled by a common, central, planning board or authority.

(7) Capitalism does not allow all classes to enjoy equal liberty. Those who own the wealth determine the kinds of laws that are made. Often these laws are made to favor the rich and to discriminate against the poor.

(8) Capitalism tends to bring about war. The desire for raw materials and markets cause nations to try to gain advantages over other nations.

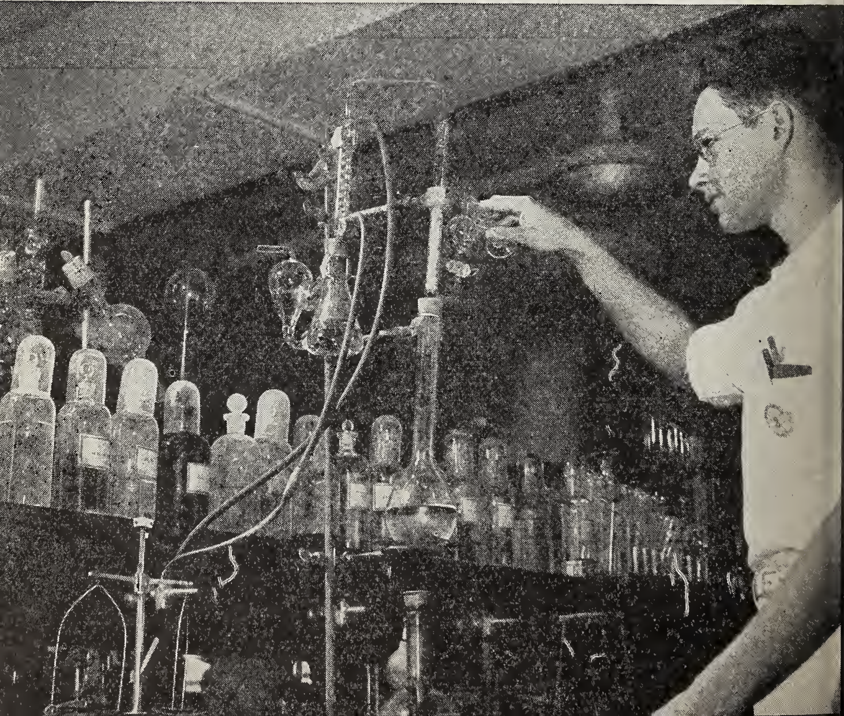
These are the charges of socialism against capitalism

How Capitalists Defend Capitalism. The American people, on the whole, do not claim that capitalism is a perfect system.

A Research Worker in Private Industry

Under socialism all scientific research on a large scale is carried on by government.

Monsanto Chemicals Corpo



But they do maintain that its advantages far outweigh its disadvantages and that the American way of life offers opportunities for welfare and happiness that cannot be found in any country that has a different kind of economic system.

In reply to the charges of socialism, those who prefer capitalism advance the following arguments:

(1) Private ownership of wealth is a positive good. The hope of accumulating wealth is a worthy incentive for effort; it stimulates initiative and causes individuals to work and save. Private savings accumulate and are invested in factories and other forms of productive equipment. As a result, the capital of the nation increases, which makes possible the production of more and more goods and services at lower costs.

It is a worthy desire for one to wish to accumulate wealth, at least some of which may be left to one's relatives or others. It is claimed that people will work harder to produce and save if their children or other relatives are permitted to inherit wealth.

(2) It is true that part of the nation's capital is used in the production of luxuries that only the rich can afford. On the other hand, what is a luxury today may become a necessity tomorrow. At one time bath tubs were regarded as luxuries and were taxed as such. Now they are considered essential to health. In many cases the well-to-do class has served to introduce and to popularize many kinds of goods that have aided in raising the average standard of living.

It is not true that most of the nation's wealth is used to produce luxuries. The greatest opportunity for making a profit lies in producing things that a majority of the people need and buy. For example, the automobile companies that have specialized in making low-priced cars have made the most profits. Therefore, most of the capital in the nation is used to produce goods and services for which there is the greatest need.

(3) On the whole, competition is the life of trade. While competition may sometimes result in the building of too many filling stations or other kinds of business establishments, in the long run, competition results in the production of goods at a lower cost than would be likely if competition were abolished.

The desire to sell more goods causes producers to seek new and better methods of production in order that prices may be reduced and sales increased. Competition results in the production of a greater variety of goods and services. If competition were abolished, there would not be the same incentive to reduce the costs of production or to turn out a variety of goods.

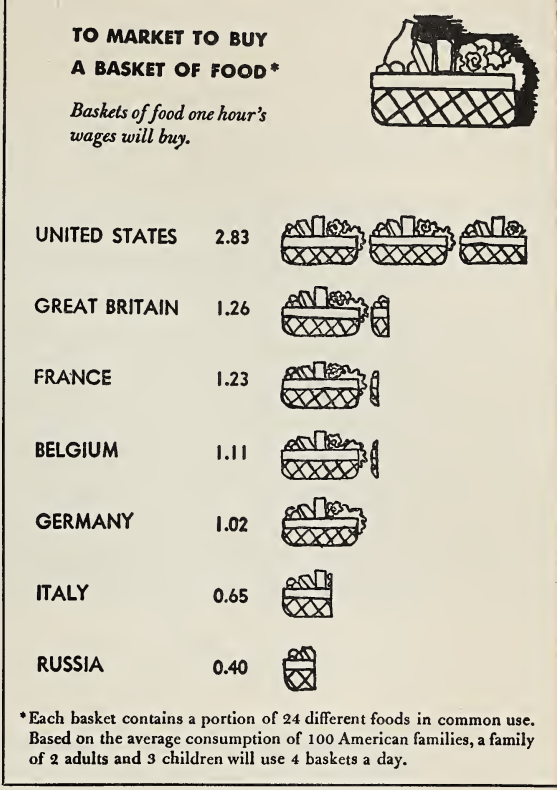
Advertising results in stimulating the use of more goods. And as demand increases, production on a large scale becomes possible, which results in lowering the unit cost of production.

(4) It is true that wastes of natural resources have occurred in the past. But it is possible for the Government to take measures to conserve our natural resources of oil, coal, timber, and soils without abolishing private property. Even if Government should acquire ownership of all minerals, this would not mean that all private property would have to be abolished. Modern capitalism does not, and never did, mean the private ownership of all wealth or the entire lack of governmental control.

It is true that workers are sometimes underpaid and that they have to work under conditions that undermine their health. But working conditions are improving, the length of the working day and week is becoming shorter, and wages on the whole are increasing.

(5) Under capitalism the division of labor results in the organization of society on a co-operative basis. In the first place, different individuals and groups specialize in producing certain kinds of goods and services that are exchanged for money that, in turn, is exchanged for goods and services produced by other individuals and groups. Thus, indirectly, shoes may be exchanged for oranges or wheat or cotton. It is for this reason that the general welfare of the country depends upon the total amount of all production.

In the second place, the owners of land, labor, capital, and the entrepreneurs are engaged in a form of co-operation, although the immediate aim of each is to get wages, interest, rent, or profits. There must be a combination of labor and capital before production can take place. On the whole, employers are willing to pay fair wages, and employees are willing that employers should make a fair amount of profit. Therefore it is



N. A. of M., Yardsticks of American Progress

A Prewar Comparison

Before World War II, the Russian factory worker had to work more than six times as long as the American to buy a basket of food.

to the interest of both that as much should be produced as is reasonably possible. In spite of the fact that individuals and groups compete with each other, we are engaged in co-operation on a vast scale. Under competition the motive for work is largely self-interest. Under socialism the motive would have to be, to a great extent, compulsion by the government.

(6) Probably it is not possible to keep production and business at the peak of prosperity. It is true that "bad times" follow "good times." But, during a depression, business has an opportunity to adjust itself. Most people who believe in capitalism admit that a certain amount of control of business by government is necessary and desirable. They concede that, to a certain extent, government should control "cut-throat" competition and practices in business. In various ways the government can keep a rein on business without destroying capitalism. Many are of the opinion that in periods of depression it is desirable for the government to spend money on public works and to decrease spending as business prosperity returns. Of course, there will be disagreements as to how far the government should go in regulating business or in trying to help business to overcome depression.

Soil Conservation Ser

An American Farmer Usually Owns His Equipment

In Russia large farm machines are used by groups of farmers who live on collective farms.

(7) Under capitalism an individual enjoys the greatest amount of freedom possible where people live together. It is true that no one is absolutely free to do as he pleases. It is also true that great wealth gives the owner some power over others. The owner of a factory, for example, has something to say about the amount of wages he pays his employees, and strong financial interests have sometimes influenced the making of laws.

On the other hand, under socialism there would be many individuals who would not be able to do as they pleased. Socialists claim that under socialism all rules for the control of business and for the payment of wages would be fixed by democratic means; that is, the people would say what should be done. But what would happen to those who disagreed with the majority? They would be compelled to do as the majority decided. And since the mass of the people would not understand how things should be run, it would be necessary to leave the decisions as to business matters to a small group. Even then, disagreements would likely arise, and the final decision would

have to be left to a dictator whose word would be the law. Therefore, while socialists advocate democracy, it would be impossible to have democracy in practice.

(8) Capitalism is no more likely to result in war than is socialism. Capitalism is not so active in stirring up discontent and trouble in other countries as is radical socialism. Unless the whole world were under socialism, there would still be as much cause for war as there now is.

The Program of Socialism. Socialism would place ownership and control in the hands of the government. The central government would own and control the big industries, like the railroads, telegraph companies, and automobile industry. Small local concerns, such as small factories or stores, might be owned and controlled by the state governments.

Under socialism the government would be the only entrepreneur, the only producer and seller of goods, the only fixer of prices. All who were able to work would have to work or go without income. Those who were unable to work would be provided for by the state. There would be differences in the amount of wages paid different workers.

The purpose of state ownership and control is to increase production and to give each deserving person a larger amount of goods and services. In order to do this, planning boards in communities and regions would be organized to decide what should be produced in the various parts of the country. The local board would report to the state board, which, in turn, would report to the national planning board. Thus a plan for the whole nation would be mapped out. And when the plan was once established, everyone would be compelled to work in accordance with it. It is not likely that unrestricted criticism would be permitted, for if everyone were allowed the right of free criticism, the plan might be upset and confusion would result.

The Policy of Socialism. The Socialist Party of the United States usually represents the majority of the socialists in this country. It advocates the establishment of socialism by peaceful, lawful means. The leaders do not favor violent revolution

as the desirable way to overthrow capitalism. They urge a gradual change to socialism. According to them, the people should be educated to desire a change in the economic order and to bring about the change by voting to give the Federal Government more and more power.

Communism. Communism is like socialism in some respects. It favors:

(1) Collective ownership and control of the instruments of production and of all consumers' goods.
(2) Abolition of private income in the form of interest, rent, and profits.
(3) Wages as the only form of income.

According to the communist group, communism differs from socialism in that it contends that (1) wages should be the same for all classes of workers; (2) money should disappear, workers to be paid by the use of tickets that could be exchanged for certain kinds of goods. Such services as housing, transportation, electricity, fuel, and possibly food should be "free" to all. The slogan should be "From each according to his ability; to each according to his need."

One of the principal differences between socialism and communism lies in the methods that are proposed to bring about the destruction of capitalism. While most socialists advocate peaceful methods, most communists assert that a violent, bloody, and ruthless revolution is the only way that capitalism can be destroyed. According to the teachings of Karl Marx, who is considered the "father of communism," it is necessary for the proletariat, or working class, to seize the power of government. When this is attempted, a reign of terror will follow, during which time there will be established a "dictatorship of the proletariat." The nonproletarians will then be removed, by taking their positions and wealth from them. If they resist, they will be killed.

After the dictatorship of the proletariat has been established and the government has assumed control of all economic, social, and political activities, the people will be educated to understand and to believe in communism. The followers of Marx

hold that eventually everyone will come to accept communism and to love it to such an extent that political government will not be necessary and will "wither away."

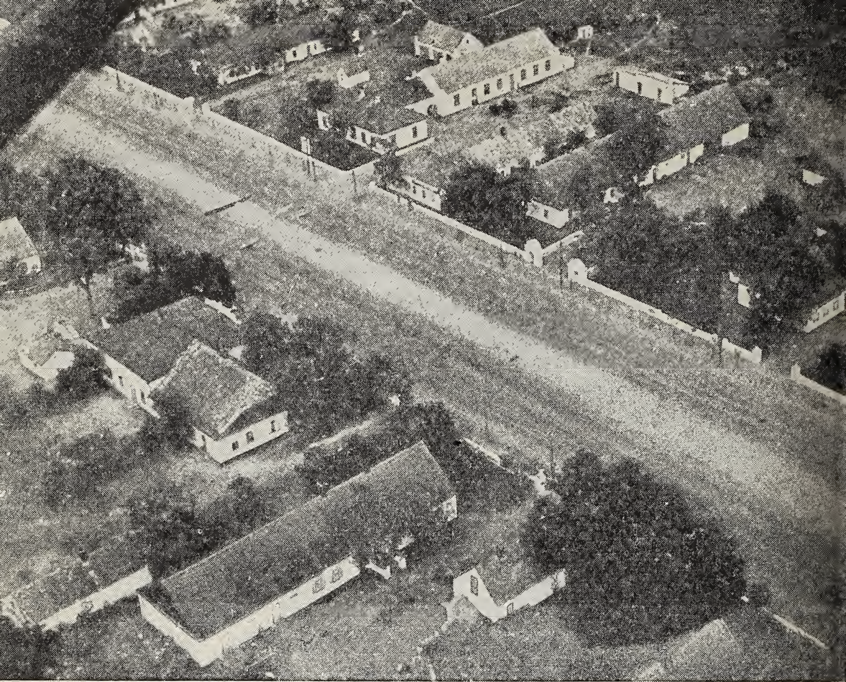
In fairness, it may be stated that for many years before its dissolution in 1944 the Communist Party in the United States did not insist on as radical means to achieve their ends as did communists in other countries. In 1944 the leaders of the party formally announced that communists would not seek office on a party ticket, but would adopt the policy of supporting the most liberal candidates in all elections, regardless of the tickets on which they may run for office.

Communism makes no pretense of advocating freedom. It holds that should communism be established, no one would be allowed to express criticism. Religion is opposed, particularly the Christian religion, because it tends to prevent people from using violent means in resisting injustice. Religion is called an "opiate" of the working class because it teaches meekness and kindness rather than resentment when injustice occurs.

Socialism in Russia. After the revolution in Russia in 1917, the communists tried to set up a communistic state. There were fewer than 100,000 communists out of a population of 150 millions, but they were well organized. And by means of killing those who opposed them, they were able to gain control of the army and the government.

Under the new order all the features of communism that we have listed above were to be put into practice. The undertaking, however, was too great, although untold numbers were killed in an attempt to compel everyone to accept the new system. Lenin and Trotsky, who headed the Russian Revolution, advocated world-wide revolution and dictatorship by the proletariat. Eventually the leaders had to compromise by adopting a system of socialism. For example, workers are paid wages that vary widely. Under pure communism each worker would be paid equal amounts or according to his need.

Under the present system, positions in the government are limited to those who are known to be "good" communists. Those who have not shown the right degree of enthusiasm for the government and its leaders are expelled from the party and



So

A Collective Farm Village in Russia
Each family is permitted the use of an acre or two of land and a small amount of livestock and poultry. Farm machinery is owned by the collective, and all farmers work together.

in many cases punished with a loss of position, imprisonment, or even death. Organizations of the party are found in towns and other communities, and in every case they are under the leadership of a zealous communist. The local organizations are grouped into regional organizations, which, in turn, are bound together in the All-Russian Congress.

But the All-Russian Congress is not the real lawmaking body of the nation. The Congress elects a Central Committee and other committees. These committees then elect the Political Commission, which is presided over by a Secretary who is the dictator of the nation. The Commission is composed of the Secretary's closest friends, who are the leading members of the Communist Party in Russia. It is this Commission, composed of party leaders and dominated by the Secretary, that is the supreme lawmaking body and power. Because of the close and rigid organization of the leaders in all parts of the nation, it is

Sovfoto

Russian Iron and Steel Workers

To increase their production workers study diagrams indicating the production of the blast furnaces that they operate.

possible for one man to dictate the policies for more than 170 millions of people. In 1944 the leaders of Russia stated that no longer would the communists there attempt to foment revolution in other countries, but would give their attention to making Russia a strong nation.

The Underlying Motive of Fascism Is Economic. The fundamental purpose of *Fascism* (and of Nazism) is to keep or to place control of production and wealth in the hands of a class of "leaders." It is more generally recognized now that the professions of racial superiority and the persecutions of minority groups by the Nazis before and during the war were only devised as means for achieving the underlying aims of those who aspired to control the economic life of Germany. At first many of the leading industrialists in that country supported Hitler and supplied the money needed to put him into power. But

when the Nazis became the most powerful group in Germany, they discarded all those who disagreed with them, including many of the big industrialists and financiers who had formerly supported them.

Under Fascism the State Is Supreme. In Fascist countries the individual has no rights that government has to respect. The state is thought of as a superbeing, a spiritual body, that is supreme in all things. In Germany and Italy the government could do no wrong, for whatever it did was right, according to the idea of Fascism. The head of the state was the leader, who in Germany was called "der Fuehrer" and in Italy "Il Duce." The leader possessed full dictatorial powers.

Fascism Means a Planned Economy. According to the teachings of Fascism, private as well as public wealth must be used as the state directs. Therefore, in a Fascist country, planning boards and organizations decide, direct, and control production. These boards may fix the amount and the kinds of goods to be produced and may determine prices. The organizations and the methods differ in name from those in Russia, but in practice they are similar in some important respects.

In order to carry out the economic plans of the government, both the owners of business and the workers are organized. The purpose of organization is to make it easier to put into practice the aims, and the policies of the government. The owner of a factory is appointed the "leader" for his establishment, and employees are required to co-operate with him. Strikes and lockouts are not permitted.

Fascism Is Totalitarian. This means that Fascism takes possession of the rights of all and that no one has a right unless it is given to him by the state. Religious belief and activities are permitted so long as they do not interfere with the aims and teachings of Fascism. Freedom of speech is not permitted. One is not allowed to speak or to write in critical terms of the government or of its leaders. Those who exercise the most zeal in praising the leader and who work hard to co-operate with the local leaders are most likely to receive rewards and promotions. In Germany, positions of leadership were reserved for the

members of the Nazi party. In Italy, only members of the Fascist party could hold responsible positions.

In order to cultivate the patriotism of the people, Fascism teaches national or racial superiority. The German Nazis, who composed the ruling party, insisted that the "pure" Germans or Nordics are superior to all other people. In Italy the aim was to make the people feel that they were better than those in other nations who are of a different racial stock. Likewise, the Japanese claim to be superior to all Asiatics.

Under Fascism ideas and standards of art and music are influenced or fixed by those in authority. Science and literature are encouraged, but each must be pursued for the purpose of fostering the cause of Fascism. Thus Fascism is not merely an economic theory or system. It concerns itself with every phase of the life of the individual. There is no such thing as private life as we understand the term.

Is Capitalism in Danger? In spite of the fact that we hear a great deal of talk about other kinds of economic systems, the number of people in the United States who would abolish capitalism is evidently small. There are some socialists and communists, who frankly admit that they are opposed to capitalism. And some "liberals" charge that certain "conservatives," who may be businessmen or political leaders, are really Fascists in their beliefs and aims. Whether particular statements of this kind are justified, however, is difficult to determine. Moreover, as we know, it is always comparatively easy to make charges and to call names.

The situation, however, does not necessarily indicate that the people believe that capitalism is a perfect form of economic order. On the contrary, nearly everyone who has given any thought to the matter concedes that many economic conditions in the United States could be improved. But it is usually taken for granted that the improvements that are needed can be made within the framework of the existing capitalistic system.

It seems logical to think that the rapidity with which improvements in economic conditions will take place will depend upon two things. One of these is the degree of the enlightenment and information of the people with respect to economic matters.

The other is the willingness of the people to work together in solving the economic problems that affect the general welfare. It is now generally conceded that a policy of *laissez faire* with respect to business and industry cannot be relied upon to bring about the highest possible degree of general welfare. But before anything will be done to remedy the defects in our society, people must become aware of the conditions that need remedying. And then they must seek the most appropriate and suitable methods to provide the remedy. In some cases it is probable that new and different laws will be needed. But if laws are to observe and protect the rights of all groups, it will be necessary for the great majority of all voters to take an intelligent part in local, state, and national politics.

In other words, economic progress under capitalism depends upon economic understanding, an interest in the general welfare, and willingness on the part of all to co-operate in solving our economic and social problems.

QUESTIONS ON THE CHAPTER

1. Upon what ideas are the various "schools" of socialism in agreement?
2. What is meant by "production for use"?
3. Why is capitalism accused of being wasteful?
4. Why is it charged by socialists that capitalism tends to bring about war?
5. Explain this statement, "Competition is the life of trade."
6. How would socialism attempt to prevent depressions?
7. Why must criticism and freedom of speech be restricted in a totalitarian state?
8. There is a socialist party in the United States. Could a capitalist party exist in Russia? Give reasons for your answer.
9. What is meant by a "dictatorship of the proletariat"?
10. Is private enterprise and initiative encouraged under Fascism? Why, or why not?
11. What is the meaning of each of the following terms?

    (a) **capitalism**
    (b) **communism**
    (c) **Fascism**
    (d) **Nazism**
    (e) **planned economy**
    (f) **socialism**

APPLICATIONS OF THE CHAPTER

1. Report on a newspaper item or magazine article dealing with capitalism; one dealing with socialism or communism; and one dealing with Fascism.
2. Would the adoption of socialism mean the surrender of a great deal of the personal freedom that we now enjoy? Consider (a) the necessity for planning under socialism; (b) the necessity for stamping out criticisms and for obtaining absolute obedience to the will of the central government; (c) the economic ignorance of the masses of the people; (d) the natural desire for power and recognition on the part of individuals; (e) the possibility of the greater production of goods and services; (f) any other factors.
3. In some respects does our governmental and economic order resemble those of socialism and Fascism? Consider (a) public education; (b) roads, streets, and publicly owned waterworks and other utilities; (c) parks and playgrounds; (d) public health and sanitation; (e) police protection; (f) protection from fires; (g) the Interstate Commerce Commission; the Tennessee Valley Authority and other power projects undertaken by the National Government; the Agricultural Adjustment Administration and other measures and organizations adopted by the national or state governments for the regulation and control of business and of our ways of living.
4. How does our economic system differ from socialism and Fascism?
5. Discuss instances in which people work for things other than profits. Compare the ideas of "production for profits" and those of "production for use." What is implied by each expression? Discuss.
6. Is it possible for extreme socialism, like that in Russia, or for Fascism to exist unless it is supported by armed force? Why?
7. In what ways do extreme socialism and Fascism resemble the old absolute monarchies?
8. Theoretically, which is the most efficient: capitalism, socialism, or Fascism? Is efficiency the most important thing to consider in choosing a type of economic organization?
9. Some people claim that socialism has been a failure in Russia. Others maintain that it has been a success. How do you account for these differences in opinion?
10. It is sometimes said that socialism has contributed much to our present economic system by calling attention to certain shortcomings in our system. What is implied in this statement?
11. It has been said that under socialism people are just as selfish as they are under capitalism. What do you think?

12. If we are to preserve capitalism, is it becoming increasingly important for our people to read and think? What types of reading and thinking are most needed? What else is needed?
13. How did the ideas behind capitalism and democracy, on the one hand, and the ideas behind totalitarianism, on the other, lead to World War II?

TOPICS FOR SPECIAL REPORTS

1. Why most Americans do not believe in socialism.
2. Restrictions on personal freedom in Italy and Germany before the war.
3. Instances in which freedom of discussion is prohibited in this country.
4. How the adoption of socialism would change economic conditions in the United States.
5. How capitalism may be preserved.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Are there any fundamental differences between socialism and communism?
2. Are there signs that this nation is moving toward Fascism (or toward socialism, if the latter topic is preferable)?
3. Is the lot of the workingman in Russia worse than it was before the establishment of socialism?
4. Can the value of personal freedom be expressed in terms of money?

UNIT VIII

Government

What services are rendered by government, and how they are paid.

Harold M. Lam

Government

Government is necessary to the existence of society.

CHAPTER 30

GOVERNMENT AND WHAT IT COSTS

When America was being settled, clearing the land of trees was often a difficult job. After the pioneer settler had felled the trees, cut off the branches and piled them into heaps, and chopped the trunks into sections of fifteen or twenty feet in length, the land still was not ready for use. Before anything else could be done, the logs had to be disposed of by burning.

But in order to burn them it was necessary to roll the logs together and to pile some of them on top of the others. To do this called for more strength than any one man possessed. Therefore when he was ready, the settler invited his neighbors to his logrolling. Incidentally, not to be invited to a logrolling by one's neighbors, was considered a slight. The work was heavy and called for rugged strength. But it was tackled with a spirit of zest and rivalry, accompanied by noisy expressions of good humor. At noon or in the evening, after the logs had been rolled, a plentiful meal of plain but nourishing food was served. In spite of the heavy work, logrollings were enjoyable events in the lives of the early settlers.

The old-fashioned logrolling was an early American institution. It was clearly a simple form of co-operation. A man's neighbors were eager to help because it was the accepted way of getting a difficult job done that was too big for the individual. If one helped others to clear their land of logs, he felt no hesitancy in asking them to help him. Therefore, no legal compulsion was needed to enlist the co-operation of those who lived in a community.

In a similar manner the early settlers co-operated in many kinds of undertakings. For example, the roads in communities were built by those who contributed their services. In the beginning no one was compelled by law to help build a road. It was only after communities and states became more thickly settled that individuals were required by law either to work

on roads a minimum number of days or to pay taxes for the building and the upkeep of highways.

Government Is a Form of Social Organization. Government may be defined as the supreme form of social organization that possesses the legal power to cause the people to co-operate in supplying certain services. In a democratic form of government it is assumed that all the services of government are needed and are used to promote the welfare of all the people. The reason why government is charged with the responsibility of providing certain services is that the people believe that by working collectively they can obtain the services at a lower cost than if they undertook to obtain them by individual effort.

Preparing Dot Maps for Agricultural Reports

This service in the field of agriculture is only one of many rendered by the Federal Government.

Ewing Gall

Modern Government Provides Many Services. We need protection against those who would intentionally or unintentionally do us harm. But we do not hire armed guards to protect us and our property. We depend upon officers of the law to do that. We need protection against unscrupulous persons who would sell us food or medicine that would injure our health. But we do not employ a private chemist to analyze the groceries and the medicines we buy. Instead we expect government inspectors and other law-enforcement officers to discover and punish those who try to sell us those things the use of which would prove harmful. We could not get along very well without roads and streets. But, of course, we do not build them ourselves. We look to the city, the county, the state, or the Federal Government to provide them. Parents want their children to have an education. But very few of them hire private tutors or teachers. Most of them send their children to public schools that are built and kept up by government. And if a foreign army or navy tries to invade the country, our shores are protected by the soldiers, the sailors, the marines, and the airmen of the United States Government.

We do not have the space here to list all of the things that government today is called upon to do. The following, however, are some of the things that are done by government:

Protects property
Protects individuals from violence by others
Protects the country from invasion by other nations
Enforces business agreements
Prohibits unfair competition between business concerns
Protects consumers against the sale of adulterated and misbranded goods
Prohibits some kinds of false advertising
Regulates the services and the rates of public utilities
Prohibits business combinations that are intended to monopolize production and trade
Regulates communication industries
Maintains postal facilities
Builds and maintains highways and streets
Provides public sanitary facilities
Licenses the use of automobiles
Improves waterways
Conserves forests and other natural resources

Provides the governmental machinery for a system of social security
Gathers information at home and abroad that will aid business
Gathers and publishes information pertaining to labor and working conditions
Provides agencies for settling labor disputes
Inspects banks and regulates credit supplied by banks
Protects individuals from undue annoyance by others
Provides schools and institutions of higher learning
Aids individuals and groups who suffer disaster from floods and storms
Regulates certain prices in war time
Establishes qualification standards for certain occupations
Builds and maintains electric-power facilities
Provides certain kinds of banks
Provides hospitals and medical aid to certain types of individuals
Extends financial aid to other governmental units
Provides recreational facilities
Maintains facilities for protection against fire
Builds and maintains public waterworks and gas systems
Provides work for unemployed persons in time of serious business depression
Provides and regulates money and currency
Establishes pensions for war veterans
Carries on scientific experiments and research that is intended to aid agriculture and other industries
Conducts research designed to protect and to improve health
Maintains prisons for the segregation of lawbreakers
Provides street lighting
Operates public libraries
Requires employers to observe certain minimum standards as to safe and healthful working conditions for their employees
By means of taxation, tries to prevent too great a concentration of wealth in the hands of the few
Protects certain industries from competition from foreign producers

Some of the services that government renders are familiar to you, and you probably take them for granted. Some of the activities that are carried on by government, however, are matters of which you are not aware. But they should be of concern to you and to every citizen, because what government does affects us in some way, whether we know it or not. And, in addition, we have to pay for all the services the government performs.

What Are the Proper Functions of Government? It is difficult to answer this question to the satisfaction of everyone. Years ago it was usually thought that there were only three things that government should do. It should (1) protect the people against violence and crime and from invasion by the armed forces of other nations; (2) protect individuals from injustice and oppression by others; and (3) build and maintain certain public works that would be of great service to all the people and which it would not be profitable for private business concerns to undertake. This was the view expressed by Adam Smith in his *Wealth of Nations* nearly one hundred and seventy-five years ago. And it is the view that is held by some people today.

On the other hand, there are many persons who hold that government should undertake to supply any and all services that will promote to the greatest degree the general welfare of the people. They maintain that a policy of *laissez faire* on the part of government with regard to business affairs does not promote the general welfare nor result in the greatest possible degree of freedom on the part of individuals. How far government should go in providing services for the people is a difficult question to decide. At any rate, we do know that the functions of government have expanded greatly since the days of Adam Smith.

Ours Is a Dual Form of Government. You recall that the Constitution was adopted in 1789. Before the Constitution was adopted, each of the states was sovereign and independent. Many of the states were fearful of joining the others in forming a united nation, because they wished to retain their freedom to act as they pleased. Even after the Constitution was adopted and the National Government was established, the union of the states was regarded by many as merely a sort of a confederation. Among the most important reasons for forming the union was the need for regulating trade between the states and the desire for protection against designs any European nations might have on the territory claimed by the states.

Therefore when the Constitution was adopted, the states reserved the right to carry on certain activities within their

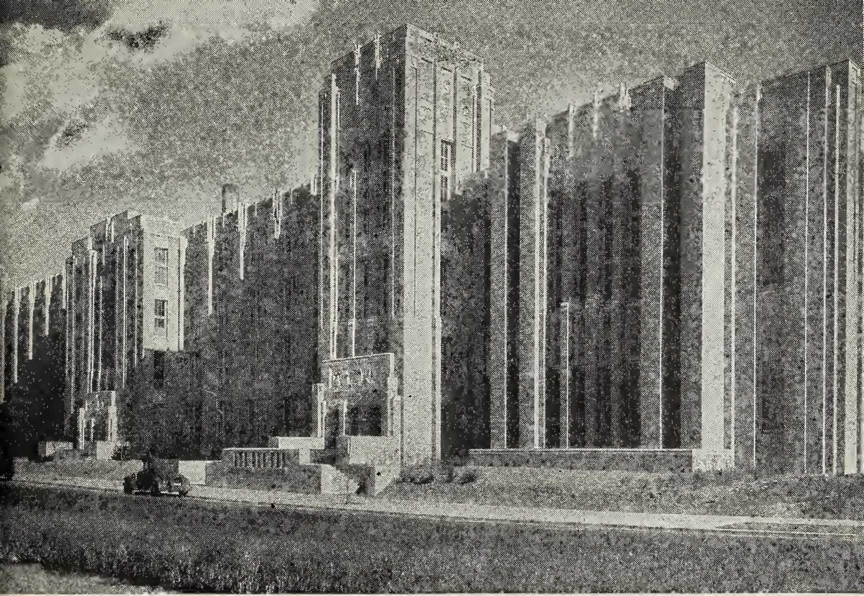
own borders. They also retained the right to delegate to local governmental units the power to perform certain functions of government.

As a result, some kinds of services are supplied by local government, such as a school district, a county, a township, a village, or a city; other kinds of services are furnished by the state; and still others, by the Federal government. In some cases, there is an overlapping of the kinds of services, so that all three levels of government—local, state, and Federal—combine to supply a given service. For example, a few years ago during a severe business depression, many local governmental units as well as the state and the Federal governments appropriated funds for the relief of unemployed persons. Many other examples can be found to show how the lines between the scope of the three kinds of government have become less clear.

The Services and the Expenditures of Local Governments. Most of the local governmental expenditures are made for schools, streets, and social welfare. Formerly more than half of all the money spent by the three divisions of government was expended by local governments.

As a rule, the people wish to provide by local taxation for those things that seem to them to be of most direct and personal concern. For this reason local governments ordinarily spend more for education and streets than for most other things. Protection from a foreign enemy is not a local problem. If a foreign army invades the country, the invasion will affect more than the local community. It is therefore felt that all the people in the nation should support the army and the navy. Protection against most kinds of lawbreakers, however, is considered a local matter, and the community taxes itself to maintain a police force.

The same thing can be said of other local expenditures. For example, most of the benefits to be derived from streets, roads, and fire departments are received largely by the citizens in the community. For that reason such facilities are maintained by taxes derived from local sources.



National Education Association

A City School

This school building—architectectually beautiful, well equipped, well heated, and well lighted—is financed by local taxation.

The Services and the Expenditures of State Governments. On the average the total amount expended by the state governments is much less than that spent by the Federal Government. The greater part of the state governmental expenditures goes for highways, education, and social welfare, the importance of the expenditures being indicated by the order of naming. Other expenditures include those made for general government, protection, economic development, debt redemption, interest on the public debt, public utilities, and miscellaneous activities.

There seems to be a growing belief that the state should take over the support of some of the functions now maintained by local taxation. Many students of economics and taxation are saying, for instance, that the state should assume a greater part of the cost of public education. It is pointed out that some cities and communities in every state are more able to maintain adequate schools than are others. In many states there are localities in which the children have every educational advantage that good teachers and modern equipment can

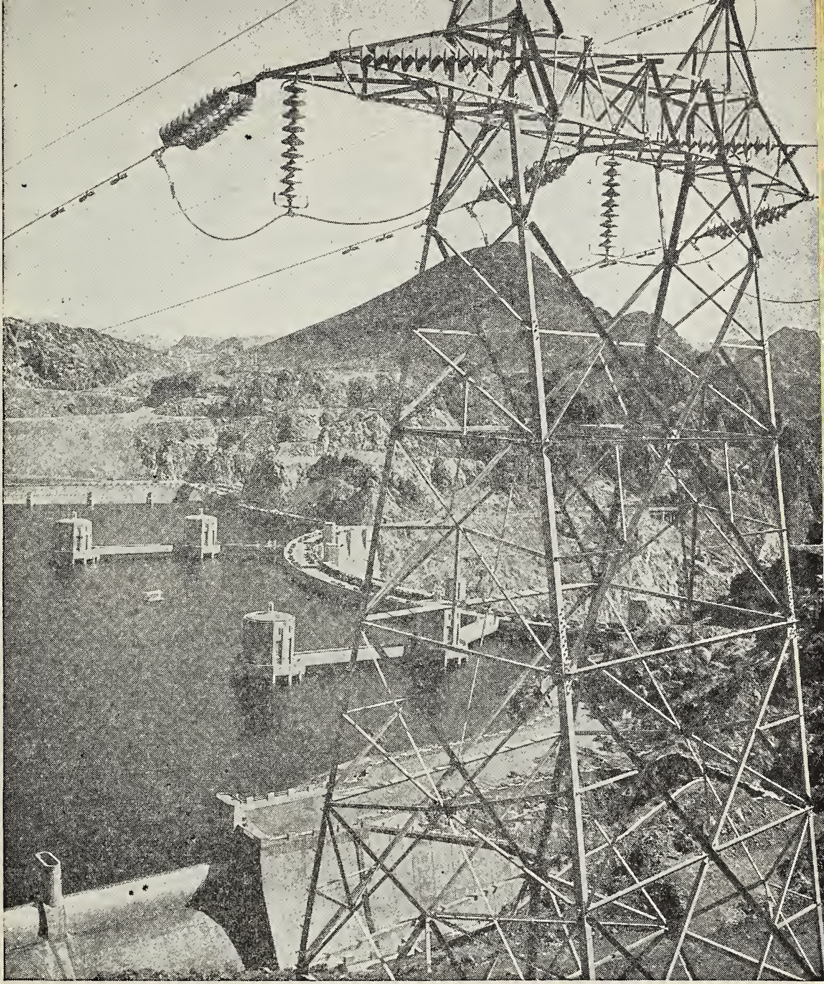
supply. In other localities the means of raising funds for the support of schools are so inadequate that only poorly paid and inferior teachers and meager equipment are provided. It is said that the state ought, therefore, to equalize educational opportunities for all by bearing most of the expense of public education.

Certain regulations of industry, the promotion of health, and other activities designed to be of benefit to the public are being considered more and more a responsibility of the state rather than of the local governments.

The Services and the Expenditures of the Federal Government. Just what the Federal Government should or should not do is a question that is often debated. For example, does the Government have the right and the power to say how a business shall be run? Should the Government attempt to regulate child labor? Should it attempt to fix minimum wages of workers? These are questions over which there has been spirited dispute.

Article I, Section 8, of the Constitution gives the Government, through Congress, power to provide for the national defense, to conduct diplomatic relations with other nations, to control immigration and naturalization, to regulate foreign and domestic trade, and to control the monetary system. The Constitution does not specifically give Congress power to pass laws for the construction of internal improvements, to aid agriculture or business, to appropriate funds for the relief of privation caused by unemployment, or to do most of the things that the Government today undertakes to do.

But the same Article does state that Congress shall have the power "To lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and the general welfare of the United States." This quotation is often referred to as the "general welfare clause" of the Constitution. Those who oppose an extension of the activities of the Government are likely to contend that the proposal is unconstitutional because it is not specifically provided for in the Constitution. On the other hand, those who favor the measure will say that it is constitutional because of the "welfare clause."



Bureau of Reclamation

Transmission Tower at Boulder Dam

In recent years the Federal Government has spent millions of dollars in the development of electric power and in soil conservation projects.

Some idea of the usual functions of the Federal Government may be gained from the expenditures of the Government in 1941. We did not go to war until December 8 of that year. But before we entered the war, our expenditures for national defense were larger than usual, because it appeared likely that

we would become involved in the war. In 1941, 52 per cent of the expenditures of the Federal Government went for national defense. The next largest expenditures were for welfare work, including work relief and general relief; conservation of natural resources, including aid to agriculture, forestry, and flood control; and old-age and unemployment insurance. Minor expenditures were made for hospitals, sanitation, care of criminals, schools, recreation, pensions, and miscellaneous purposes. In addition to these expenditures, the Government spent many millions of dollars for general purposes and for the payment of interest on the public debt.

Federal Expenditures Tend to Increase. For the fiscal year ended in 1944, the Government spent over $91,280,000,000. If each person in the United States had paid an equal share of the total amount spent by the Government that year, he would have paid about $676. On this basis a family of four would have paid over $2,700. But the government collected only about $43,557,000,000 and borrowed the remainder. Of course, most of the money ($84,980,000,000) spent by the Government that year went to defray the cost of the war.

RECEIPTS AND EXPENDITURES OF THE FEDERAL GOVERNMENT, FISCAL YEAR 1944

At close of business June 22

RECEIPTS[1]	
Total Receipts	$43,557,141,103
Principal Sources:	
Income Tax	
Withheld by employers (Current Tax Payment Act of 1943)	8,299,808,099
Miscellaneous Internal Revenue	5,217,327,845
Employment Taxes	1,291,386,665
Customs	423,686,832
Other	24,982,583,718
EXPENDITURES	
Total Expenditures (excluding public debt retirements)	$91,280,358,822
Principal Items:	
Soil Conservation and Domestic Allotment Act	402,334,105
Social Security Board	467,054,832
Interest on Public Debt	2,290,592,769
War Activities (subtotal)	84,980,759,899
Excess of expenditures (excluding public debt retirements)	48,985,421,502

[1]Does not include borrowed funds.

But for the six years before we became involved in the war, the average per capita expenditure of the Government was about $65.27 a year. In addition to this, the per capita expenditures of local and state governments amounted to about $80, making a total per capita governmental expenditures of about $145.27 a year.

Except for a short time during the War Between the States, the per capita expenditures of the Federal Government for the first 127 years of our national history never rose above $10. Then came World War I, when in 1919 it rose to more than $176. After that the annual per capita expenditures of the Government declined to as low as $29.56 in 1927. But by 1941, the year we entered World War II, it had risen to above $96.

In time of war the Government naturally spends more money than it does in times of peace. But even before we entered World War II, the long-run tendency was for the per capita expenditures of the Government to increase. The expenditures of the Government after the War Between the States were never as low as they were before. After our war with Spain (in 1898) they were higher than before. And after World War I, the average expenditures were a great deal higher than they had ever been during times of peace. Therefore, on the basis of history, it is reasonable to think that the per capita expenditures of the Federal Government for a long time will be higher than they were in 1941.

Government Obtains Money in Different Ways. The funds that the government collects but does not have to repay (such as those received in the form of taxes) are called *revenues*. Money borrowed on bonds, however, is not revenue. The term *receipts* includes money and credit received from both taxes and loans from the people.

Governmental revenues include gifts, income from government industries and from the public domain, fees and assessments, and taxes.

Taxes. A *tax* is a compulsory contribution from private wealth to be used in carrying on the functions of government. The principle underlying the right of the government to levy

contributions from wealth is that the functions of government promote the welfare of all the people and that the existence of government is essential to the existence of wealth. Taxes constitute the main source of revenue for all sorts of government, whether local, state, or Federal. The following are the most important kinds of taxes that are utilized by the local, state, and Federal governments.

(1) *The General Property Tax.* The general property tax is based on the idea that the ownership of property carries with it the responsibility of supporting the government because the government renders services in the way of protection. Furthermore, the ownership of property is supposed to indicate the ability to pay taxes. The basis for the tax is the assessed value of property, the amount of the individual's tax being a percentage of the declared value of his property.

The tax is levied without any consideration of the amount of the net income of the owner. Ever so often tax assessors prepare lists of taxable property. In most states the personal property in a given district is supposed to be listed annually by tax assessors, while real estate is listed at intervals of two or three years. Most state governments derive revenue from taxes on property. The Federal Government does not make use of the general property tax.

This tax is the source of more than three fourths of all state and local revenues. Although it remains a popular tax, its use as the means of raising most of the state revenue has been almost universally condemned by students of taxation.

(2) *Consumption Taxes.* A consumption tax is a tax that is levied upon a commodity or a service. Taxes on gasoline, tobacco, and imported goods are instances of consumption taxes.

The arguments advanced in support of consumption taxes are (1) that no one can escape payment because all are consumers, and (2) that such taxes are easy to collect.

Consumption taxes are divided into two classes: (1) excises and (2) customs duties, or import tariffs.

In general it may be said that *excises* are taxes imposed at the time of the sale of goods. They may be levied upon goods

produced in this country or upon those of foreign origin. In any case, although an excise tax may be paid to the government by the seller, as in the case of the tobacco tax, the expense of the tax is usually passed on to the final consumer.

Within recent years many proposals for the adoption of a *general sales tax* have been made. These proposals have always been met by spirited opposition. But, in spite of the objections raised, many states have adopted some form of sales tax.

The general sales tax is the outgrowth of excises or stamp taxes. It is frequently called a sales tax, a merchants' tax, a gross-sales tax, a turnover tax, a gross-receipts tax, a manufacturers' tax, a producers' tax, or by some other name. Whatever the name of the sales tax, the object is to collect taxes at the time of the sale of goods.

Customs duties, or tariffs (as the term is used here), are taxes imposed upon goods brought in from foreign countries. Such taxes are sometimes used for the purpose of raising revenue or of discouraging the importation of goods.

(3) *Income Taxes.* As the term is usually understood, *income taxes* refer to taxes levied upon the net incomes of individuals or concerns.

Net income means the amount of income after certain deductions have been allowed. For example, both single persons and heads of families are allowed a certain amount of income upon which they do not have to pay taxes. Most gifts to charity and to educational institutions may be deducted from income before the tax is calculated.

Income taxes are of comparatively recent origin. Not until the adoption of an amendment to the Constitution in 1913 did the Federal Government have the power to levy taxes on incomes. Before that time an income-tax law passed by Congress had been held unconstitutional by the United States Supreme Court. At present, taxes are levied on personal incomes as well as on the incomes of corporations. Income taxes usually constitute the main source of revenue of the Federal Government.

A number of the states also derive a great deal of revenue from income taxes.

(4) *Estate and Inheritance Taxes.* The Federal Government and all the states, except Nevada, have laws imposing taxes upon property acquired through inheritance. The Federal Estate Tax Law of 1935, as amended in 1942, provides a flat exemption of $60,000, including insurance. The rate begins at 3 per cent and increases up to a maximum of 77 per cent. Considerable variation is found in the laws of the various states, but in general the rates are much lower than those imposed by the Federal Government.

The Federal Government imposes a gift tax that is nearly as high as the estate tax. The object of this tax is to make it impossible for an estate to escape taxation because it is given to his heirs by the owner before his death.

(5) *Capitation Taxes.* A capitation tax is levied on the individual without reference to benefits received by him or according to his ability to pay. It is sometimes called a *poll,* or *head, tax.* Sometimes the payment of a poll tax is a requirement for voting.

Capitation taxes are of ancient origin and were once an important source of governmental revenue. In recent times, however, they have decreased in importance; and today, except in some states, they constitute a relatively unimportant source of revenue.

Fees and Licenses. *Fees* are amounts collected from individuals in return for services performed by the government. By paying a fee, the individual receives a special benefit from the government. The charge for recording a deed for the transfer of the title to real estate is an example of a fee.

A *license* is a form of fee. By the payment of the amount required, the individual is given the right to engage in a particular kind of business or to do a certain other thing. Licenses are issued for such purposes as the operation of stores, automobiles, taxicab companies, barber shops, and restaurants. Professional people, such as physicians and public accountants, must also take out licenses.

Rates. The term *rates* may be applied to revenues that are derived from businesses operated by the government, such as

waterworks. Frequently the income received from government-operated industries does not cover the costs of supplying the services. Whatever amounts are received, however, are classifiable as revenues.

In some cases the Federal Government engages in businesses that produce income. The central governments of some countries are much more active in industry than is the Government of the United States. In Russia, as we have seen, nearly all industry is operated by the national government. The outstanding revenue-producing enterprise operated by the Federal Government of the United States is the post office. The post office has often operated at a loss. When a loss occurs, it is generally considered justifiable, because the post office is conducted in the interest of the public welfare.

The relatively small amount of revenue derived from public industry in this country does not justify our further consideration of the subject in this connection. But the question of the future extension of government into industry is likely to become an increasingly interesting topic.

Special Assessments. *Special assessments* are payments made by the owners of land to the government for improvements that are made by the government and that usually result in an increase in the value of the land. The building and the improving of streets are the most common occasions for the levying of assessments.

The Public Domain. The term *public domain* refers to all the land owned by the government. When the term is used, we usually think of agricultural, forest, and mineral lands that are owned by local, state, or Federal Government.

Although most of the area of the United States at one time belonged to the Federal Government, the public domain has never yielded any important amount of net revenue. Most of the land was sold to settlers for nominal amounts of money, the usual price being from \$1 to \$2 an acre. This liberal policy on the part of the Federal Government was considered wise because it encouraged the rapid settlement of the land.

Most of the public domain suitable for agricultural purposes has passed into the hands of private owners. The Federal

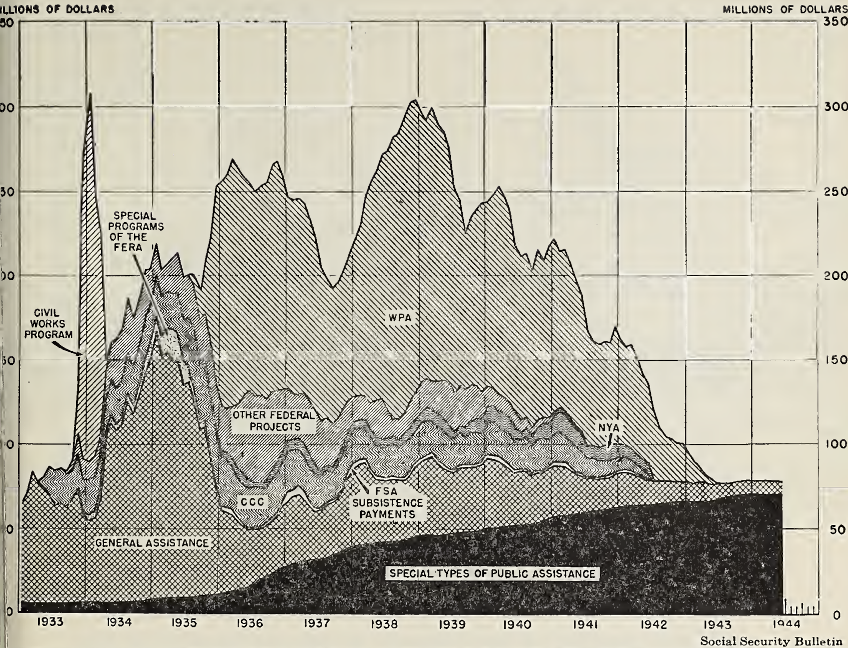
Government and the states, however, still own valuable timber and mineral lands, the disposition of which constitutes a public problem. As long as these lands are undeveloped, they cannot produce an income. Some of the questions involved in the disposition of these lands are: Shall the lands be held for the use of future generations or until the exhaustion of our present privately owned resources demand their use? Shall they be disposed of to private individuals without restrictions as to development, or shall the government supervise their use? Shall the natural resources now owned by the state governments and the Federal Government be developed by the governments themselves?

Gifts. It would probably be a surprise to many people to realize that our several types of government receive millions of dollars' worth of gifts every year. This is a fact, however, especially in the case of local governments. In nearly every town there are buildings, parks, art collections, or sums of money held in trust for specific purposes, that came into the possession of the government as the result of gifts from individuals. It is impossible to say how much the total of all such donations amounts to, but that it runs into many millions of dollars is certain.

Can Taxes Be Reduced? Only a qualified answer should be given to this question. From the beginning of our Federal Government, taxes have shown a general tendency to increase. The reasons for this tendency have been (1) wars, (2) the increasing demands for more services from government, and (3) sometimes inefficiency and graft in governmental bodies.

World War I resulted in an enormous increase in our national debt. Before that war our national debt amounted to only $1,000,000,000. By 1919 it had jumped to $26,596,701,648. By 1930 the debt had been reduced to nearly $16,000,000,000. Then for several years the Government engaged in unprecedented programs of public works and spending, which more than doubled the national debt.

For some time many persons viewed with great alarm the constantly rising debt. Some seriously wondered what would



Federal Expenditures to Create Jobs and Render Aid

Earnings of persons employed under Federal work programs and payments to recipients of public assistance in the continental United States, 1933–44.

happen to our financial structure if we should become involved in war. But when war did come in 1941, appropriations for national defense were made in terms of tens of billions of dollars. By 1945 the national debt had risen to more than $250,000,000,000. On a per capita basis, this meant that each person in the United States owed about $1,500 to the Government. By June, 1944, the per capita amount of interest cost of the Federal debt was about $17 annually. Since that time both the amount of the debt and of the interest cost have risen.

Should the War Debt Be Paid? With a national debt of more than $250,000,000,000, the interest on which runs into several billions of dollars, will it ever be possible to reduce Federal taxes and maintain the usual functions of government?

If we should decide to pay off all the national debt, it would be necessary to raise by taxation a sum sufficient to cover the

White Motor Compa

Mobile Artillery

Protection against foreign foes is a function of the Federal Government.

ordinary expenses of government, to pay the interest on the unpaid national debt, and to pay a part of the principal of the debt each year. If the debt is, say, $250 billions, it would be necessary to raise more than $11 billions each year, in addition to the sums needed for the ordinary expenses of government and the interest on the debt, if the debt were to be paid within twenty years; and half that amount if it were to be paid within forty years. And there are some who insist that the debt must be paid.

On the other hand, there are others who maintain that it is not necessary ever to pay the debt. Their arguments run as follows:

1. When a national debt is owed to another nation or to individuals abroad, the only way to pay the debt is to send purchasing power out of the country each year for the purpose of paying a part of the principal and the interest on the unpaid balance.

2. But if the debt is owed to the citizens of the country that owes the debt, the situation is different. Most of the bonds are held by insurance companies, commercial banks, and pur-

chasers of savings bonds. The remainder are held by trust estates, educational institutions, business concerns, and a relatively few wealthy individuals.

All of the institutional bondholders, like insurance companies, commercial banks, and educational institutions, are necessary parts of our economic system. They must have income, a part of which they can obtain from the interest on Government bonds that they hold. If they did not have some way of earning an income from investments, they would have to get it in some other way. For example, insurance companies would have to charge higher insurance premiums, universities would have to charge higher tuition rates, and so on. And banks would have to charge more for their services. Therefore, taxpayers who pay the interest on Government bonds that are held by institutions would have to pay more for insurance, education, bank services, and so on, if these institutions did not receive interest on the government bonds that they held.

3. If an attempt is made to pay off the debt, taxes will be high and so much money will be taken by the Government that people will not have a great deal to spend for goods. And the taxes on business will be so high that goods can be produced only at prices that consumers cannot afford to pay.

It is said, however, that if the national income is kept at a level of from $125 to $150 billions, the payment of the interest alone would not impose a great burden on the people. The money to pay the interest to the bondholders would almost immediately go back into circulation, which would stimulate production and business.

If it should be decided that it was best for the Government not to redeem or pay off the government debt, those who hold bonds would continue to receive interest. There would be a regular market where the bonds could be bought and sold. Then if a bondholder needed the money he had invested in a bond, he could sell his bond in the market to anyone who wished to buy it.

Whether the national debt should be paid is a question about which you will hear more as you grow older. The final solution to the question is important, for it will affect everyone.

Should Government Spend Less? It is often said that the Government spends too much money. For example, the per capita expenditures of the Federal Government in 1941 were more than ten times the amount forty or fifty years before.

But before we say that Government spends too much and that taxes are too high, we must consider that many conditions in our national life have changed during the last few decades. In 1900, for example, there were only about 700,000 pupils in high school; now there are more than 6,000,000. Then the automobile was just coming into use, and little was spent for roads. Unemployment was not considered a national problem. Now the Government has undertaken to do something to provide work for many who cannot find employment in private industry and business. In addition, poverty is no longer looked upon as a purely individual or local problem; it is considered the duty of the National Government to aid in trying to relieve want and insecurity when they are not due to one's own laziness. And in many other affairs the Government is taking an interest that did not show in former times.

In other words, people are trying to get more services by means of collective action than they formerly did. They believe that they can pool their funds and co-ordinate their efforts and by means of government obtain many services more economically than they could if they depended upon their own efforts or upon private enterprise.

If we have more wars, if we want an increasing number of governmental services, and if the citizens are not vigilant as to the efficient use of public revenues, we may expect a constant, and perhaps rapid, increase instead of a decrease in taxes. Moreover, that increase will take place regardless of which political party may be successful in elections.

QUESTIONS ON THE CHAPTER

1. In paying taxes, what do we pay for?
2. What are the proper functions of government?
3. What is meant by "ours is a dual form of government"?
4. What types of services are furnished by each of the three types of government under which we live?

5. Show by the per capita expenditures how the Federal Government expenditures have increased.
6. What is the difference between government revenues and government receipts?
7. What kinds of gifts have been made to government?
8. Name five types of taxes frequently imposed.
9. What are the various terms used to designate the sales taxes?
10. How can taxes be reduced?
11. What is the meaning of each of the following terms?

(a) **capitation tax**
(b) **consumption tax**
(c) **customs duty**
(d) **estate tax**
(e) **excises**
(f) **fee**
(g) **general property tax**
(h) **general sales tax**
(i) **income tax**
(j) **inheritance tax**
(k) **license**
(l) **net income**
(m) **poll tax**
(n) **public domain**
(o) **rates**
(p) **receipts**
(q) **revenue**
(r) **special assessment**
(s) **tax**

APPLICATIONS OF THE CHAPTER

1. Discuss some local problems pertaining to taxes.
2. Report on a recent newspaper item or magazine article dealing with taxes.
3. During the War Between the States and the World Wars, it was necessary for the Federal Government to borrow most of the funds needed in financing governmental expenditures. Explain how the money was obtained and how it probably will be repaid. Why was it not obtained by taxation?
4. Can you think of any justification for maintaining the United States Post Office at a loss? What would be the effect, if any, if postage, newspaper, and parcel rates were raised sufficiently to yield a large profit every year?
5. Some people claim that the Federal Government and the state governments should own all the timber and mineral lands, and that the forests and mines should be controlled by government. Discuss this question. Consider (a) the wastefulness of present methods of operation; (b) competition in the use of lands; (c) the length of time it will take nature to replace timber and minerals that have been exhausted; (d) the duty of the present generation to future generations; and (e) the fact that owners must pay taxes on the land whether or not the minerals and the timber are used or sold.

6. Why is an acquaintance with the sources of taxes important? Is a person likely to take a more active interest in government if he knows the sources of governmental revenues?
7. Show the relation of each of the following to the income and revenue of your town, city, county, and state government, and the National Government: fee, rate, revenue, income, receipts, loan, tariff, customs, excise, assessment, public domain.
8. Why, in your opinion, was it necessary to amend the Constitution before the Federal Government could levy an income tax? If an income-tax law was unconstitutional before the amendment, why was such a law passed later? How can we be certain that any law is constitutional?
9. Find out the tax rates on general property in your city or county.
10. Give a report on the amounts of taxes and the purposes for which taxes are spent in your city or county and in your state. Do you think too much is being spent for any one purpose? for which purpose? Why do you think so?
11. Does your state have an income-tax law? Report on the subject.

TOPICS FOR SPECIAL REPORTS

1. What government does for me.
2. The sources of taxes in my city (or my county).
3. The sources of taxes in this state.
4. National and state income-tax rates.
5. Expenditures of the Federal Government from 1930 to 1945.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Is (specify a governmental activity) necessary?
2. Is that government best which governs least?
3. Should the Federal Government support public education to a greater extent than it does?
4. Could the expenses of county government be decreased and could the duties of government be carried on just as well as they are at present if county lines were abolished and county governments were combined?

CHAPTER 31

PAYING THE COST OF GOVERNMENT

If you have never sent a check to the city, the county, the state, or the Federal Government for taxes, you may feel that you are not a taxpayer. Nevertheless you do pay taxes. For the prices of many of the articles you buy contain *hidden taxes.* That is, manufacturers, merchants, and other businessmen pay various kinds of taxes, and in many cases all, or at least a portion, of the taxes they pay are added to the prices of the articles they sell. The tax thus becomes a part of the selling price. But it is concealed, or hidden, because it is usually difficult to recognize the part of the price that goes to cover taxes.

Therefore everyone of us bears a part of the burden of the cost of government. The man who receives $500,000 a year income pays most of it to the government in income taxes. Likewise the owner of real estate pays a property tax. And most people who work for a living have to pay taxes of one kind or another.

What Principles Should Govern Taxation? Few people enjoy paying taxes. At the same time, most of them realize that the expenses of government must be met in some way. Therefore if they feel that the government is not wasteful and that taxes are fair, most taxpayers do not complain a great deal.

Since government exists for the good of all, the taxes that people pay for the support of government should be fair and just and should be based upon sound principles.

A Tax Should Be Based on the Ability of Individuals to Pay. It is generally recognized that justice demands that every citizen should contribute to the support of government in proportion to his ability. The general services that the government renders are enjoyed by all, directly or indirectly; and everyone should therefore share in the support of government.

On first thought it may seem that, since everyone is supposed to share equally in the general benefits of government, each one should pay an equal amount of taxes. Government, however, supports the present economic order, and only by the existence of government is private property and income made secure. If it were not for government, therefore, few persons could accumulate and hold property. Consequently the greater the wealth that a person has, the greater are the benefits that he derives from the services of government. Likewise, those whose incomes are large are more able to pay taxes than are those whose incomes are small. For these reasons it seems only fair that everyone should contribute to the financial support of government in proportion to his ability.

Now it is one thing to say that everyone should pay taxes according to his ability. It is quite another thing, however, to make comparisons between the tax-paying abilities of various individuals. Consider the case of Young and Heflin, the former having an income of $1,000 and the latter an income of $100,000. If a tax of 1 per cent were levied, Young would pay $10, while Heflin would pay $1,000. Would the amount paid by each be in accordance with his ability to pay?

In order to answer this question intelligently, we should have to consider other factors in each case. For the purpose of illustration, suppose that Young has a wife and two children, while Heflin is a single man with no dependents. Obviously these factors would have to be considered.

Assume, however, that neither of the men has the responsibility of dependents. Would the amount paid by each be in accordance with his ability? It evidently would not. In other words, Heflin could pay 1 per cent of his income with less sacrifice than could Young. We conclude, therefore, that the ability to pay taxes increases faster than does the increase in income.

For this reason income-tax rates usually, but not always, are *progressive* to a certain point. That is to say, the greater the amount of income received, the greater is the percentage of the tax, up to a certain point, demanded by the government. In order that a tax may be really progressive, the rate must increase somewhat more rapidly than the increase in income.

If the tax increases at the same rate as the income, it is said to be *proportional.* A *regressive* tax is one that grows proportionately less as the ability to pay taxes increases.

The table below shows the estimated per capita income of the people in the various states in 1941. Since then prices of goods and wages have changed greatly. But eventually about the same relative relations between incomes in the states probably will be restored.

This table shows that the average citizen in some of the states found it more difficult to pay a given amount of taxes than did the average citizen in other states. For example, on the basis of income received, a taxpayer in Delaware or Nevada was at least four times as able to pay a tax of, say, $25 as was a taxpayer in Mississippi.

PER CAPITA INCOME, BY STATES, 1941[1]

STATE	INCOME	STATE	INCOME
United States	$ 532	Montana	$544
Alabama	242	Nebraska	419
Arizona	451	Nevada	800
Arkansas	242	New Hampshire	516
California	742	New Jersey	643
Colorado	517	New Mexico	320
Connecticut	767	New York	749
Delaware	831	North Carolina	299
District of Columbia	1,192	North Dakota	360
Florida	444	Ohio	605
Georgia	290	Oklahoma	341
Idaho	446	Oregon	542
Illinois	637	Pennsylvania	574
Indiana	491	Rhode Island	663
Iowa	444	South Carolina	267
Kansas	410	South Dakota	372
Kentucky	298	Tennessee	294
Louisiana	347	Texas	399
Maine	477	Utah	445
Maryland	588	Vermont	485
Massachusetts	703	Virginia	381
Michigan	594	Washington	600
Minnesota	501	West Virginia	374
Mississippi	202	Wisconsin	496
Missouri	471	Wyoming	606

[1]*Financing Federal, State, and Local Governments*, 1941, Bureau of the Census, p. 104.

A Tax Should Be Certain. If possible, the amount and the time of payment of a tax should be announced far enough in advance of collection to permit provision being made for payment. Moreover, it is necessary that the government shall be able to estimate as nearly as possible the amount it expects to collect from taxes during the next fiscal period.

A Tax Should Be Convenient. The time for the payment of a tax should be made as convenient to the taxpayer as possible. When the annual income of the individual or the concern is distributed uniformly over the year, it ordinarily makes little difference as to when a tax is to be paid. If the income is seasonal, as in the case of the farmer and many businessmen, there is a time during the year when it will be more convenient to make payment than at any other time.

A Tax Should Be Economical. It is important that the cost of collecting taxes be as low as possible. Taxes that are expensive to collect are uneconomical to the government and costly to the citizen. The expenditures necessary in the collection of taxes return little or no benefit to the taxpayer.

Taxes May Be Used for Several Purposes. Traditionally the general idea underlying taxation in this country has been that of obtaining funds with which to defray the necessary expenses of government. As a rule, the local law-making bodies, state legislatures, and Congress have professed that this idea should be followed in levying taxes. And, to a certain extent, the principle has usually been accepted that taxes should be levied according to the principles of ability to pay and of the benefits received from the government. There have been exceptions, however, in both theory and practice. But generally speaking, this has been the attitude of the people and of law-making bodies.

But there are many who say that the taxing power of government should be used for controlling incomes and for redistributing wealth and controlling business and industry. Those who hold this idea maintain that the government should use its power of taxation to take away part of large incomes for

the purpose of building roads, streets, schools, libraries, hospitals, and the like, in order that people with small incomes may be able to enjoy many things that they cannot afford.

Taxes Are Direct or Indirect. Sometimes the person from whom a tax is collected is not the real tax-bearer. For example, in the case of the tax on tobacco products, the manufacturer pays the tax to the government, but usually he then adds the amount of the tax to the selling price of the cigars, cigarettes, or other form of tobacco product. The final consumer eventually bears the tax burden in the form of the increased price he pays for the tobacco. Apparently the manufacturer pays the tax; in reality he merely acts as a tax collector.

Those taxes that are paid directly to the government by the persons upon whom they have been imposed are said to be *direct taxes*. Those taxes that may be shifted to others, as in the case of the tobacco tax, are called *indirect taxes*.

The Federal and the local governments raise about half of their revenues by means of direct taxes. But it is estimated that on the average the states obtain only about one fourth of their revenues in this way, the remaining three fourths being raised by the use of various kinds of indirect taxes, such as sales taxes.

Generally speaking, one who bears a tax should be aware that he is helping to pay the expenses of government. For that reason a direct tax is preferable to an indirect tax because the collection of the latter often results in the unconscious support of government by those who are not aware that they are paying a tax. It is very desirable for everyone to feel that he helps to pay the cost of public services. If he realizes this fact, he is more likely to take an active and intelligent interest in government.

What Principles Govern the Collection of Governmental Revenue? In the light of the principles that have been established in the preceding discussion, we are in a better position to appraise the various taxes that are now in existence.

Fees, Licenses, and Special Assessments. Each of these types of revenue is justified largely on the theory of special

benefits conferred upon individuals. Little or no attempt is made to adapt the amount required to the ability of the individual to pay. Most local and state governments rely upon these sources for a great deal of revenue.

The use of fees as a means of compensating public officials is sometimes justifiable, but the fee system often results in graft. Therefore, the payment of governmental officials by means of fees is not to be commended as a general policy.

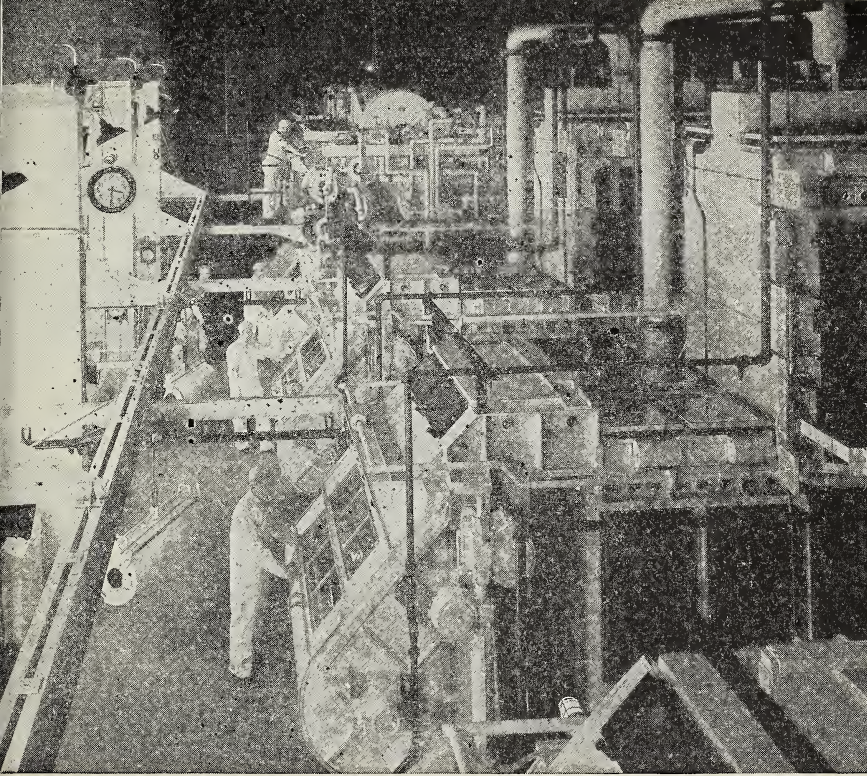
The General Property Tax. The general property tax is a tax upon the value of all property, including both real and personal property. The taxation rates vary from state to state, and often the rates vary within a state. For example, the rate of taxation for city real estate may be very different from the rate on farm property in the same state.

In 1941, the year we entered the war, taxes on property accounted for most of the revenue raised by all of our combined units of government. But when the governmental units are considered separately, we find that corporate income taxes furnished most of the revenue obtained by the Federal Government. The state governments received most of their revenue from taxes on motor fuel. Local governmental units, including city and county governments, raised most of their revenue from taxes on general property.

The general property tax has so many shortcomings, and the tax results in so much injustice, that, as a major source of revenue, it is generally condemned except for local purposes.

In the first place, the theory of the general property tax rests upon a false assumption. It assumes that the ownership of assessed property is an indication of the ability to pay taxes. If most of the wealth of the country existed in only a few forms, the ownership of property would be a fairly reliable indication of an individual's ability to pay taxes.

But when some people receive huge salaries, the ownership of property is only one evidence of tax-paying ability. For example, a farmer may own a great number of acres of land that yield him little or no profit. At the same time a professional or businessman may have little capital except his talent or ability, for which he receives an enormous income. It is evident that in



Eastman Kodak Co.

A Step in the Manufacture of Photographic Film

The equipment used by businesses in the manufacture of the products they sell is subject to a general property tax.

these two cases property ownership does not indicate the relative abilities of the two men to pay taxes.

Another evil that arises from the general property tax is tax evasion. The idea behind the general property tax is the taxation of all personal property as well as real estate. An attempt is therefore made to discover and tax all land, houses, household furniture, jewelry, stocks, bonds, mortgages, and other forms or evidences of wealth not exempt from taxation. Some forms of wealth cannot be concealed, while others can be concealed easily. Naturally in listing their property with the government, unscrupulous persons—perhaps most people are more or less unscrupulous in this connection—will fail to include all their property.

Moreover, if all property is reported, the tendency is to undervalue it. To report property at its full value means the payment of a larger amount of tax than if the property is undervalued. If the assessor tried to determine the fair valuation of all property reported, he would be confronted with an almost impossible task. For example, the average assessor would find it very difficult to determine the value of a diamond or a stock of goods in a store.

Again, as an attempt is made to tax all property, double taxation frequently results. For example, if a tax is levied upon a factory building and also upon the capital stock or the bonds of the factory, double taxation is the result. Taxes are paid on the physical property and also upon the shares of stock or upon the bonds.

Finally, taxes on houses and factories can be shifted to tenants and to those who buy the products of factories. For example, there is a tendency for owners of apartment houses to add the amount of the taxes they have to pay on the property to the rent they charge their tenants. And whenever he can, the factory owner naturally tries to collect the amount of taxes he pays by increasing the price he charges for his product.

Consequently, we may summarize the objections raised to the general property tax by saying that (1) the ownership of property is not a reliable indication of ability to pay taxes, (2) the general property tax makes it possible for many persons whose incomes do not come from the ownership of tangible property to escape their part of the burden of taxation, (3) the tax encourages dishonesty in that many persons are tempted to make false tax reports, (4) it is practically impossible to determine the true value of property for a tax levy, and (5) in many cases taxes on property can be shifted to someone else.

These criticisms are made against the recognized defects of the general property tax as a means of obtaining any important portion of state or Federal governmental revenue. They do not imply that for local taxation purposes the general property tax should be abandoned. The tax yields a comparatively certain amount of revenue, which recommends it for consideration. But students of taxation contend that it should not be made the chief source of state revenue.

Consumption Taxes. These taxes, in most cases, result in increasing the cost of commodities. They are used primarily for the purpose of raising revenue and, except in a very vague, general way, do not conform to the principle of ability to pay.

It may be argued that those who purchase the greatest quantity of gasoline, for example, are better able to pay the tax than are those who buy in smaller quantities. Even so, the tax is proportional and not progressive; that is, it does not increase in proportion to the ability to pay. A man who is barely able to afford the price of ten gallons of gasoline pays just as much tax as a millionaire who buys an equal amount.

Moreover, consumption taxes are nearly always indirect. They are shifted to the consumer. Again, such taxes are levied upon that part of the income that is spent, and not upon what is saved. Consequently the more a person saves, the smaller is the amount of consumption taxes he pays. But the more he saves, the more able he is to pay taxes.

The justifications given for consumption taxes are (1) that such taxes are convenient to collect, (2) that they may be used as a means of discouraging the use of certain kinds of goods, and (3) that they yield large revenues.

Business Taxes. A *business tax* is a levy imposed on a form or class of private business enterprise because of its existence in a particular form. For example, a gross income tax on railroads, a net income tax on corporations, and a premiums tax on insurance companies are examples of business taxes. Business taxes are a favorite means of raising government revenue. There are several reasons why such taxes are frequently employed. They are comparatively easy to collect. They produce a relatively steady income to the unit of government that levies the tax. As a rule they are indirect, and for that reason businessmen feel that most or all of the tax can be shifted to someone else. And, finally, it is claimed that business enterprises enjoy many benefits from the existence of government, and for that reason they should be willing to pay for such benefits by means of special taxes.

The Federal Government levies a tax on the net income and the stock of corporations. Corporations also must pay *excess-*

profits taxes if their net incomes are above specified amounts. There are three kinds of pay-roll taxes that are levied upon certain employers. The purpose of one of these taxes is to provide funds for general old-age security benefits as required by the Social Security Act; one is levied upon public carriers, such as the railroads, to provide a special kind of social security for the employees; and a third is imposed upon certain classes of employers in order to provide funds for unemployment insurance.

Most of the state governments have laws taxing corporations. Several states tax railroads and public-service corporations. Most of the states levy taxes on banks. All the states have taxes of one kind or another on insurance companies. Several of the states have *severance taxes*, which are taxes on natural resources that are removed and sold—such as coal, mineral ores, oil, and timber. Three or four of the states impose special taxes on chain stores.

Scaling Logs

Several states have severance taxes on natural resources, such as timber, that are removed and sold.

Soil Conservation Ser

The taxes mentioned above do not include all the business taxes that are levied by the Federal and the state governments. But it indicates the wide range of such taxes.

Personal Income Taxes. Much of the revenue received by the Federal Government comes from personal income taxes. And more than half of the state governments obtain considerable portions of their revenues from such taxes.

An *income tax* is one that is levied on the basis of income received. The amount of the tax may be stated as a certain number of dollars and cents, depending upon the size of the income; or it may be indicated as a percentage of the income.

The tax is levied only on taxable income, and not on gross income. *Taxable income* is calculated by subtracting certain allowable deductions and credits from the gross income. Among allowable deductions in calculating Federal income taxes are the following: contributions to charitable or educational institutions; certain kinds of trade losses and expenses; business losses from theft, casualty, bad debts, and the sale of some kinds of property; depreciation of business property.

For most taxpayers the credits take the form of the exemptions, the size of which depends upon his marital status and his dependents. Under the Federal law passed in 1944 a dependent is one who is closely related to the taxpayer, who does not have a gross income of $500, and who receives over half of his support from the taxpayer. Dependents include children, brothers or sisters, parents, grandparents, nephews, nieces, and other close relatives.

Arguments For and Against the Income Tax. There are several strong arguments in favor of income taxes as a means of obtaining governmental revenue. A tax on income may be graduated and the rate made progressive so as to levy the tax somewhat in accordance with the individual's ability to pay. The tax tends to "stay put," and is not easy to shift.

On the other hand, the amount of the yield of income taxes is uncertain, because the total collected depends upon the incomes of the taxpayers. In periods of business depression the yield falls off; and it rises in periods of prosperity. It requires high-grade administration and supervision on the part of tax

officials in order to prevent widespread tax evasion. And in addition some other objections have been raised.

Methods of Collecting Personal Income Taxes. There are two ways by which personal income taxes may be collected. First, they may be paid by the taxpayer sometime during the year following that for which the income is earned. In such a case the taxpayer files a report, or "tax return," which shows the amount of his total taxable income and the amounts of his allowable deductions and credits. In most cases he may pay the tax at the time he files his tax return, although he is usually permitted to defer part of the payment until some time later.

Second, the income tax may be collected on the "pay-as-you-go" plan. Under this plan the amount of the tax is withheld at the time income is received. Under the Federal law most wage earners have the amount of their income taxes deducted by the employer, who sends it to the Treasurer of the United States. If for any reason the amount withheld by the employer does not equal the tax that is due, an adjustment is made at the end of the year.

Estate and Inheritance Taxes. When an inheritance tax is properly framed, it can be made to conform to the principle of ability to pay. An estate that is inherited comes in the nature of a windfall and is additional to the regular income of the inheritor. Consequently it would seem that one who inherits a great deal of wealth could ordinarily feel no real sacrifice in paying a part of the value of the property to the government.

There are those who believe that the government should take the value of all producers' goods upon the death of the owner. Such an arrangement, however, would mean the gradual adoption of state socialism, because nearly all productive property sooner or later passes by inheritance.

Capitation Taxes. Capitation taxes have little to recommend them. They are largely the vestige of an ancient practice of granting immunity to persons from serving in the army by the payment of a poll, or head, tax.

Two weighty arguments may be advanced against capitation taxes: (1) These taxes bear no relation to the ability of the

Ewing Galloway

Auditing Federal Income Tax Returns

The reports of the incomes of individuals and corporations are inspected by the Internal Revenue Division of the Treasury Department to determine whether the amount of taxes is correct.

taxpayer to support the government, and (2) they are often difficult to collect. Persons who own no property seldom pay capitation taxes. If an attempt is made to compel nonproperty owners to pay, the expense of collection is greater than the taxes collected.

What Taxes Should Be Used? In criticizing taxation systems and taxes, we should give a word of caution. In the first place, we must keep in mind that it is comparatively easy to work out a theory of taxation that seems just, but it may be much more difficult to apply the theory under actual conditions. For example, some just taxes may not be economical from the standpoint of collection. They should therefore not be levied.

As many persons as possible should pay direct taxes and thus be more conscious of the functions of government and the cost of governmental services. The taxpayer should be made to realize that he is a taxpayer.

Some persons, however, receive such small incomes that it would not be practical to levy a tax upon their net incomes. Hence, if they are to be made to pay a tax, the tax must be levied on some other basis than net income.

For these and other reasons it may sometimes be necessary, in the building of a taxation system, to sacrifice theory to practicality.

QUESTIONS ON THE CHAPTER

1. Explain and illustrate the following statements: A tax should be based upon the ability of individuals to pay; a tax should be certain; a tax should be convenient; a tax should be economical.
2. Does the amount of one's income affect his ability to pay taxes?
3. Does per capita income in the United States vary?
4. For what purposes are taxes used?
5. In the light of the principles of taxation that are discussed in the chapter, discuss each of the following: fees; licenses; special assessments; capitation taxes; the general property tax; consumption taxes; estate and inheritance taxes; business taxes; personal income taxes.
6. What are the arguments for and against income taxes?
7. What are the two ways by which personal income taxes may be collected?
8. What taxes should be used in raising revenue for government?
9. What is the meaning of each of the following terms?

   (a) **business tax**
   (b) **direct tax**
   (c) **excess-profits tax**
   (d) **hidden tax**
   (e) **income tax**
   (f) **indirect tax**
   (g) **progressive tax**
   (h) **proportional tax**
   (i) **regressive tax**
   (j) **severance taxes**
   (k) **taxable income**

APPLICATIONS OF THE CHAPTER

1. Study the kinds of taxes paid by the people in your community.
2. Discuss a current newspaper item or magazine article dealing with taxes.
3. Jones says that every man and woman should pay the same amount of taxes because everyone receives the same benefits. Criticize his contention.

4. A famous tax collector once said that the secret of a good taxation system is the possibility of "plucking the goose with as little squawking as possible." What did he mean? Do you agree? Why? Which kind of tax will produce the more "squawking"—a direct tax or an indirect tax?
5. In recent years a number of states passed "general sales tax" laws. These laws impose taxes on the goods sold by retailers to consumers. Are such laws in accordance with the principles discussed in this chapter? Upon what grounds, if any, can a sales tax be justified?
6. When Jones listed his real estate with the tax assessor, he stated that its value was $25,000. On the day before, however, he had refused to take $50,000 for it.
   Smith had just purchased a piece of property for $50,000, and he listed it at that amount.
   Why did Jones list his property at $25,000? Did Smith pay a larger tax than he should have paid? Can it be said that the general property tax places a premium upon misrepresentation? (Give complete answers.)
7. Moss says that there should be a capitation tax. Darter contends that capitation taxes are wrong in principle. What arguments might each give to justify his position?
8. Is there an income-tax law in your state? What are its provisions? What are the arguments for and against income taxes?
9. In 1933 Congress passed the first Agricultural Adjustment Act, which provided for a processing tax. Under this law manufacturers had to pay a certain amount on each pound of cotton, each bushel of wheat, or each unit of any other raw agricultural product used. The object was to obtain funds with which to aid the farmers, who were very much in need of help. Discuss this law.
10. Should the income of a large corporation be taxed at a higher rate than that of a smaller concern? In your answer consider the following:
    (a) Should taxes be levied in accordance with the principle of ability to pay? Should other principles be followed? What principles?
    (b) The largest American corporation reports that its stock is held by more than 600,000 stockholders, none of whom holds as much as 1 per cent of the total stock. On the other hand, in the case of many smaller corporations, a few individuals own all the stock.
    (c) Are big business and industrial concerns desirable? What factors should you consider in giving your answer?
    (d) If it is desirable to "soak the rich," is the taxation of large corporations at a higher rate than smaller corporations the best method to use?

11. It has been said, "The power to tax is the power to destroy." Discuss this statement.
12. What are the prospects that local taxes will decrease in the future? that state taxes will decrease? that Federal taxes will decrease?
13. Why should some persons be exempt from income taxes? Do such persons pay any kind of tax? Should they be made to realize that they help to support the government? How can they be made to realize this fact?
14. Should the general property tax be abolished? Should any use be made of it? What use?

TOPICS FOR SPECIAL REPORTS

1. Progressive taxes.
2. The qualifications needed by legislators in order that they may frame just and adequate tax laws.
3. Tax-exempt bonds.
4. Some instances of double taxation.
5. Some taxes that can be shifted and some that cannot.

PROBLEMS FOR DISCUSSION OR INFORMAL DEBATE

1. Should ability to pay be the only principle followed in levying taxes?
2. Should the wealthier sections of the country and the incomes of the rich people be taxed heavily and most of the funds thus obtained be spent in the poorer localities by building roads, schoolhouses, etc.?
3. Should the general property tax be abolished?
4. Is a sales tax just?

SUGGESTED READINGS

CHAPTER 1

Building America Series, Vol. VI, *We Americans*
CLAY, *Economics for the General Reader*, Ch. I
CROW AND CROW, *Learning to Live With Others*, Ch. VIII
FAIRCHILD, *Economics*, Ch. I
GORDON, *Economics for Consumers*, Ch. 2
MARSHALL, LEON C., *Readings in the Story of Human Progress*, Ch. 14
MOORE AND HOOCH, *Readings in Modern Economics*, Ch. 1
MOSHER AND ASSOCIATES, *Responsible Citizenship*, Ch. 20
PERRET, *Man's Work and World*, Ch. I

CHAPTER 2

ANSHEN, *An Introduction to Business*, Chs. 2-3
BAKER, *The Wonderful Story of Industry*
Building America Series, Vol. I, *Men and Machines*
CHASE, *Men and Machines*
FAIRCHILD, *Economics*, Ch. VI
FAULKNER AND OTHERS, *The American Way of Life*, Chs. 9–13
HAMM, *The American People*, Ch. XVII
KIDGER, *Problems of American Democracy*, Ch. XI
MOORE AND HOOCH, *Readings in Modern Economics*, Ch. 2
O'ROURKE, *You and Your Community*, Chs. 21 and 29
PATTERSON, *Social Aspects of Industry*, Chs. II-III
PERRET, *Man's Work and World*, Chs. I–XIX
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Vol. I, Ch. 12

CHAPTER 3

ADAMS, *Getting and Spending*, Ch. I
Building America Series, Vol. I, *Youth Faces the World;* Vol. V, *The American Craftsman, and Finding Your Job*
CROW AND CROW, *Learning to Live With Others*, Ch. XVI
FAIRCHILD, *Economics*, Ch. XV
FAULKNER AND OTHERS, *The American Way of Life*, Ch. 34
GARVIAN AND OTHERS, *Our Changing Social Order*, Chs. 30-31
GORDON, *Economics for Consumers*, Ch. 3
HAMM, *The American People*, Ch. VIII
MOORE AND HOOCH, *Readings in Modern Economics*, Chs. 7-8
MOSHER AND ASSOCIATES, *Responsible Citizenship*, Ch. 25
NECKELL AND DORSEY, *Management in Family Living*, Part III
O'ROURKE, *You and Your Community*, Part Six
POMEROY AND FISK, *Applied Business Law*, pp. 505–511
ROHLFING AND OTHERS, *Business and Government*, Ch. VI
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Vol. II, Ch. 37

CHAPTER 4

Adams, *Getting and Spending*, Ch. XVII
Anshen, *An Introduction to Business*, pp. 486–488
Building America Series, Vol. II, *We Consumers;* Vol. V, *Advertising*
Clark, Blake, *The Advertising Smoke Screen*
Garvian and others, *Our Changing Social Order*, Ch. 30
Gordon, *Economics for Consumers*, Ch. 3 and Part III
Kidger, *Problems of American Democracy*, Ch. III
Moore and Hooch, *Readings in Modern Economics*, Ch. 8
Mosher and Associates, *Responsible Citizenship*, Ch. 25
O'Rourke, *You and Your Community*, Ch. 19
Shields and Wilson, *Consumer Economic Problems*, 3rd Ed., Chs. 16-17
Taylor and others, *Main Currents in Modern Economic Life*, Vol. II, Ch. 38

CHAPTER 5

Adams, *Getting and Spending*, Ch. VI
Anshen, *An Introduction to Business*, Ch. 4
Building America Series, Vol. I, *Transportation;* Vol. II, *Steel, Farmers*
Fairchild, *Economics*, Chs. II–IV
Faulkner and others, *The American Way of Life*, Ch. 2
Gee, *The Social Economics of Agriculture*, pp. 13–19
Mosher and Associates, *Responsible Citizenship*, pp. 490–496
Patterson, *Social Aspects of Industry*, pp. 80–137
Spengler and Klein, *Introduction to Business*, Ch. VI

CHAPTER 6

Anshen, *An Introduction to Business*, Part III
Building America Series, Vol. I, *Men and Machines*
Fairchild, *Economics*, Chs. VI–VII
Faulkner and others, *The American Way of Life*, Ch. 2
Moore and Hooch, *Readings in Modern Economics*, Ch. 4
Mosher and Associates, *Responsible Citizenship*, Ch. 21
O'Rourke, *You and Your Community*, Ch. 21
Spengler and Klein, *Introduction to Business*, Ch. V
Taylor and others, *Main Currents in Modern Economic Life*, Ch. 8

CHAPTER 7

Anshen, *An Introduction to Business*, Chs. 9–12
Fairchild, *Economics*, Ch. XI
Moore and Hooch, *Readings in Modern Economics*, Ch. 3
Pomeroy and Fisk, *Applied Business Law*, Unit X
Spengler and Klein, *Introduction to Business*, Ch. I

CHAPTER 8

Anshen, *An Introduction to Business*, Chs. 10-11
Fairchild, *Economics*, Chs. XII-XIII
Faulkner and others, *The American Way of Life*, Ch. 16

GARVIAN AND OTHERS, *Our Changing Social Order*, Ch. 29
KIDGER, *Problems of American Democracy*, Ch. VII
MOORE AND HOOCH, *Readings in Modern Economics*, Ch. 3
O'ROURKE, *You and Your Community*, Ch. 21
PERRET, *Man's Work and World*, Ch. XVI
ROHLFING AND OTHERS, *Business and Government*, Chs. XXVIII-XXIX
SPENGLER AND KLEIN, *Introduction to Business*, Chs. II–IV
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Chs. 14–17

CHAPTER 9

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GEE, *The Social Economics of Agriculture*, Ch. XIV
GORDON, *Economics for Consumers*, Chs. 18-19
KIDGER, *Problems of American Democracy*, Chs. IV-V
MOORE AND HOOCH, *Readings in Modern Economics*, pp. 122-123
MOSHER AND ASSOCIATES, *Responsible Citizenship*, pp. 514–520
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PATTERSON, *Social Aspects of Industry*, Ch. XX
ROHLFING AND OTHERS, *Business and Government*, Ch. XXII
SHIELDS AND WILSON, *Consumer Economic Problems*, 3rd Ed., Chs. 34, 35, 36
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Vol. II, Ch. 39

CHAPTER 10

ANSHEN, *An Introduction to Business*, Ch. 17
FAIRCHILD, *Economics*, Ch. XXIX
GEE, *The Social Economics of Agriculture*, Ch. XII
MOORE AND HOOCH, *Readings in Modern Economics*, Ch. 5
ROHLFING AND OTHERS, *Business and Government*, Ch. VI
SPENGLER AND KLEIN, *Introduction to Business*, Part IV
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Vol. II, Ch. 39

CHAPTER 11

Building America Series, Vol. VIII, *Planning for the Post-War World; The East Indies; Spanish-Speaking Peoples*
FAIRCHILD, *Economics*, Ch. XXX
GEE, *The Social Economics of Agriculture*, pp. 93–97
KIDGER, *Problems of American Democracy*, Ch. XVIII
MOORE AND HOOCH, *Readings in Modern Economics*, pp. 303–327
O'ROURKE, *You and Your Community*, pp. 304–306
PERRET, *Man's Work and World*, pp. 469-470
SPENGLER AND KLEIN, *Introduction to Business*, Ch. XXX
TAYLOR AND OTHERS, *Main Currents in Modern Economic Life*, Vol. I, Chs. 28-29

CHAPTER 12

ANSHEN, *An Introduction to Business*, Chs. 25-26
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GLOSSARY

Most of the economic terms used in the text are defined briefly in this glossary. If a term is not included here, refer to the index which follows.

Agent (marketing). A middleman, such as a broker or a commission man, who buys and sells for others.

American Federation of Labor (A. F. of L.). A national federation or association of trades and other labor unions.

Apprentice. One who is under contract to work for another in order to learn a trade.

Arbitration. A method of settling a labor dispute by leaving the decision to a third party.

Articles of copartnership. A written agreement setting forth the terms of a partnership agreement.

Assets. Owned things of value; property.

Bait. Merchandise displayed only for the purpose of enticing people into a store.

Balance of trade. The difference between the value of exports and the value of imports.

Balance sheet. A statement of assets, liabilities, and present worth.

Bank draft. An order by one bank on another directing the latter to pay a certain sum of money to the order of the person named in the draft.

Barter. The exchange of one commodity for another without the use of money.

Bears. Traders on organized exchanges who are interested in seeing prices fall; those who expect prices to fall.

Bimetallism. The use of two metals at a fixed ratio of value as a money standard.

Black list. List of unacceptable workers.

Board of directors. A group elected by the stockholders to manage a corporation.

Bond. A long-time promissory note given by a corporation in exchange for a loan.

Boycott. Refraining by concerted action from having dealings with another person or group; a refusal by workers to use materials made by a concern.

Brassage. Charge made by the Government to cover the cost of coinage.

Broker. A middleman who brings prospective buyers and sellers together.

Budgeting. Planning expenditures in accordance with the estimated income.

Building and loan association. A savings institution designed to aid home building.

Bullion. Uncoined money metal.

Bulls. Traders on organized exchanges who are interested in seeing prices rise; those who expect prices to rise.

Business corporation. A corporation that is organized to make profits.

Business cycle. A period of time that includes the characteristic alternating phases of good and bad times in business.

Business unit. The factors of production organized under one management.

Capital or capital goods. Anything that is intended to be used in the production of goods or services; producers' goods.

Capital stock. Shares of ownership that a corporation has a right to issue.

Capitalism. An economic order or theory wherein the private ownership of capital and the existence of the profit motive in production are recognized as being fundamental.

Capitation tax. A tax levied on the individual without reference to benefits received by him or according to his ability to pay; sometimes called a poll or head tax.

Carrying charge. An interest charge on an installment purchase.

Cartel. A combination by business concerns in different countries to control the prices and production of commodities.

Cashier's check. A check drawn by a bank upon its own funds.

Certified check. A depositor's check, the payment of which is guaranteed by the bank on which it is drawn.

Charter (corporation). A written instrument issued by the state or the Federal government, creating a corporation and defining the rights and the powers of the corporation.

Check. A written order by a depositor on a bank, directing the bank to pay a sum of money.

Child labor. This term is usually defined as the gainful employment of persons between ten and fifteen years of age.

Circulating capital. Production goods that are quickly used up.

Closed shop. An enterprise in which employment is limited to members of a union.

Collective bargaining. Fixing of terms of employment by representatives of the employers and of the employees.

Commercial bank. A financial institution that accepts deposits subject to check and that supplies short-term credit.

Commercial draft. A written order by one party directing another party to pay a sum of money to a third party.

Commercial paper. Promissory notes, trade acceptances, bankers' acceptances, and other negotiable instruments that may be used as a basis of loans by banks.

Commission man. An agent who receives goods on consignment for sale to consumers.

Commodity exchange. An organized exchange where standardized commodities are bought and sold by brokers.

Common stock. A share of ownership in a corporation that usually entitles the holder to a voice in the management but that does not entitle the holder to the preferential treatment accorded the holders of other kinds of stock.

Communism. A doctrine that advocates the public ownership of all capital and consumers' goods and that usually claims that violent means are justified in overthrowing capitalism.

Company union. An organization of employees in an establishment, unaffiliated with any other labor group.

Compensated dollar. A dollar, the purchasing power of which would remain fixed by changing the gold content of the dollar.

Compensatory principle. The tendency for the ratios of gold and silver to be regulated by changes in the demand for the two metals.

Competitive price. The price that is determined by competition between sellers and buyers.

Compulsory arbitration. Arbitration by a government agency that has the right to enforce its decisions in labor disputes.

Concentration (marketing). Movement of goods toward a common center.

Conciliation. Settling a labor dispute by discussion between the employer and the employees.

Congress of Industrial Organization (CIO). A national federation of industrial labor unions.

Conservation. The planned and systematic preservation of natural resources, including minerals, timber, and soils.

Consolidation. A combination of two or more corporations involving the dissolution of the former businesses and the formation of an entirely new corporation.

Consumers' co-operative. A co-operative organized for the purpose of purchasing commodities or services for its members.

Consumers' goods. Economic goods that are used directly in the satisfaction of wants.

Consumption. Using goods and services; more strictly speaking, using utilities.

Consumption tax. A tax on expenditures for consumption goods and services.

Contract. An agreement between two or more individuals or groups that is enforceable by law.

Co-operative society. A co-operative organization designed to provide services for its members, such as buying or selling goods.

Copyright. The exclusive right that is granted by the Federal Government to an author or an artist to produce and sell works of literature or art that he has created.

Corporation. "A corporation is an artificial being, invisible, intangible, and existing only in the contemplation of the law," authorized by a charter that gives continuous existence to an enterprise without reference to the lives of the persons who may be connected with the enterprise.

Craft guild. A medieval organization of workers.

Credit. The ability to obtain goods or services in exchange for a promise to make payment later.

Credit instrument. A written instrument used in creating or in transferring credit, such as a promissory note or a commercial draft.

Credit union. A co-operative association intended to promote saving among its members and to provide them with loans when needed.

Creditor. One to whom money is owed.

"Crime of '73." The coinage act of Congress of 1873, by which no provision was made for coining silver dollars.

Cumulative preferred stock. Stock on which the stated amount of dividend must be paid before dividends are paid to the common stockholders, the amount accumulating each year until paid.

Debenture bond. A bond secured only by a general claim against the assets of the corporation.

Debtor. One who owes money.

Demand. The desire for, and the ability to buy, a good or a service at certain prices.

Demand deposit. A deposit in a checking account that may be withdrawn at any time without previous notice.

Depreciation. A decrease in value of an asset due to use or the passage of time.

Devaluation (money). Reducing the weight or content of the unit of standard money.

Direct tax. A tax paid directly to the government by the persons upon whom it has been imposed.

Dispersion (marketing). Movement of goods from a common center.

Dissolution. A process of terminating or discontinuing a business.

Distribution (national income). Apportioning the national income to the factors of production, for the most part in the form of money.

Dividend. A share of the profits of a corporation paid to stockholders.

Division of labor. Specialization of effort in production.

Domestic system. Production of goods in homes instead of in factories. This system prevailed in the period preceding the Industrial Revolution.

Dumping. Practice of selling goods in another country at a price that is below the cost of producing the goods, the objective being to get rid of a surplus or to destroy an industry or business in a foreign country.

Durable consumers' goods. Consumers' goods that may be used over and over again for a considerable period of time.

Economic goods. Material goods that require effort to produce. (The term is sometimes used to include services.)

Economic law. A tendency that develops in connection with the production, exchange, use of goods and services, and the distribution of the national income. Economic laws explain the cause and effect of relationships in the economic world.

Economic order. The ways of making a living and the customs and laws relating to economic matters.

Economics. That branch of social science that is concerned with man's efforts to produce and to use material and immaterial things to satisfy wants.

Elastic currency. A currency that expands and contracts in volume as the demands of business change.

Elasticity of demand. The extent to which changes in price affect the quantity of a good that is consumed.

Elasticity of supply. The extent to which changes in price affect the quantity of goods offered for sale.

Eleemosynary corporation. A corporation that is organized for social, educational, or charitable purposes.

Eminent domain. The right and power of the government to take private property for public use.

Engel's laws. Statements of relationships that tend to exist between the size of personal and family incomes and the percentages that people spend for various classes of goods.

Entrepreneur (enterpriser). One who assumes the risks of a business.

Estate tax. A tax upon an inherited estate.

Excess-profits tax. A business tax levied when the net income is above a specified amount.

Exchange. Changing the place and the ownership of goods and services.

Exchange value. Value based upon a comparison of marginal utilities of the goods or services involved.

Excise tax. A tax imposed on goods at the time of their sale.

Export. The result of any transaction that calls for the payment of money or credit by a foreign individual or concern to a domestic producer; a good or a service sold abroad.

Extractive industries. Industries in which the purpose is the utilization of natural resources.

Factors of production. Land, labor, capital, and entrepreneurship.

Fascism. A doctrine that, from an economic standpoint, permits the right of private productive property, but makes individuals and classes absolutely subordinate to the state; politically, a dictatorship.

Federal Reserve System. The banking system established by an act of Congress in 1913 to provide an elastic currency and to unify banking.

Fee. A charge for a government service that is of special benefit to the person receiving the service.

Fiat money. Money that circulates by reason of the order of the Government.

Fiscal. Pertaining to money matters. A fiscal period is a period of time for which the profit or loss of a business enterprise is calculated.

Fixed capital. Specialized capital; machinery, structures, equipment, etc.

Fixed cost. A cost that does not vary greatly with the volume of production.

Foreign bill of exchange. A commercial draft drawn in one state or country on a person or business in another state or country.

Franchise. A government permit that gives the owner at least a partial monopoly.

Free capital. A capital good capable of being used for various purposes.

Free coinage. The right of anyone to have bullion coined by the Government.

Free goods. Material goods that are supplied free by nature.

Free trade. Absence of restrictions on foreign trade.

Freedom of contract. The right to enter into binding agreements.

Freedom of enterprise. The right to engage in productive work on one's own account.

Future sale. A contract to sell a security or a commodity, which the seller does not own at the time, that calls for delivery at some future date.

General partnership. A partnership in which the members share equally in management and liability.

General property tax. A tax on all forms of private property, which is computed as a percentage of the assessed value of the property.

Geographical division of labor. Division of labor due to climate, soil, and other natural conditions.

Gold export point. The rate of exchange that causes gold to move out of a country.

Gold import point. The rate of exchange that causes gold to move into a country.

Gold point. The price of exchange at which it becomes more profitable to make payment in gold than to buy drafts; the point at which gold moves from one country to another in the payment of international debts.

Gold rate of exchange. The rate of exchange for the monetary units of two countries expressed in terms of the gold contents of such units.

Gold standard. A monetary unit expressed as a weight of gold; gold is the basis for the other kinds of money in the monetary system.

Good. Anything that people desire; material things or services.

Good will. Value of a business due to its reputation.

Greenbacks. United States notes used as money. They were first issued during the Civil War.

Gresham's law. The tendency for an inferior money to drive a superior money out of circulation.

Hidden tax. A tax paid by a businessman that is transferred to those who buy from him in the form of increased prices.

Holding company. A corporation that holds stock in another company or companies for the purpose of control.

Implicit interest, rent, or wages. That compensation that goes to the owner who utilizes his capital or land or who works for himself.

Import. Any transaction that calls for the payment of money or credit to a foreign individual or concern by a domestic producer; goods or services purchased from foreigners.

Income. Benefits received, or which may be claimed, the value of which is usually stated in terms of money; wealth received during a period of time.

Income tax. A tax on net income.

Index number A statistical device by which trends in prices, production, and other conditions and activities can be measured.

Indirect production. Production involving the use of machines or tools.

Indirect tax. A tax, the expense of which is borne by one person, but the final cost of which is passed on to another.

Individualism. The theory that self-reliance and individual effort should be the most important factors in providing for one's needs.

Industrial Revolution. Change in the methods of production through the rapid introduction of power and machinery during the latter part of the eighteenth century and the first part of the nineteenth century.

Industrial union. A labor union composed of all the workers in an industry, as a coal miners' union.

Industry. That division of economic activity in which the immediate aim is the production of goods.

Inflation (prices). Increase in prices due to an increase in the amount of money and credit in circulation.

Inheritance tax. A tax upon inherited property.

Injunction. A court order restraining an individual or a group from the performance of a certain act.

Inland or domestic bill of exchange. A commercial draft drawn on a person or business in the same state as the bank.

Installment credit. A form of personal or consumer credit by which the buyer may make payment in a series of installments.

Institution, economic or social. A characteristic practice, custom, or feature of an economic or social system. Also, an important economic or social business undertaking.

Intensive cultivation. The use of additional units of a factor of production after the law of diminishing returns has set in.

Interest. Compensation that goes to the owner of capital.

Investment. Putting money into property with a view to obtaining income because of the productiveness of the property.

Investment bank. An institution that supplies long-term credit and commonly serves as a medium for distributing securities to the general public.

Investment credit. Long-term credit for the purchase of land and capital goods.

Invisible exports or imports. Securities or services sold to foreigners or purchased abroad from foreigners; not material goods.

Joint costs. Costs that are common to the production of two or more goods.

Labor. Human effort, either mental or physical, that is intended to create utility.

Labor union. An organization of workers.

Laissez faire. The policy of allowing business to control itself without interference by government.

Land. Natural resources from which all of the goods that we use originate.

Law of comparative advantage. The tendency for a region to devote its resources to the production of those commodities or services in which it has the greatest advantage or the least comparative disadvantage. The law may apply also to individuals.

Law of diminishing returns. The tendency for a factor of production to yield a less than proportional return as the value of other factors utilized increases.

Law of diminishing utility. The tendency for the utility of a given unit of stock of goods to increase when the supply increases.

Lend-lease agreement. An agreement between the United States and other United Nations in World War II, providing for an exchange of goods with final settlement deferred until after the war.

Liability. The responsibility for the payment of a debt.

License. Written permission from government allowing an individual or concern to perform certain acts or to carry on a business.

Life insurance. Protection against economic loss to one's dependents or to his estate as a result of death.

Limited partner. A partner whose liability for the debts of the partnership is limited.

Liquidation. Termination of a business involving the sale of its assets.

Loan shark. One who takes undue advantage of the necessity of others in making a loan and who charges an unreasonable rate of interest.

Lobby. A persistent or organized attempt to influence a lawmaking body.

Lockout. The closing of an establishment by an employer in response to the demands of employees for more wages or a change in working conditions.

Managed currency. Broadly speaking, a currency that is changed in order to offset changes in the price level. This term also refers to the proposal to abolish a metallic standard by the use of paper money. It may also include the tabular standard.

Margin. Amount of money that the buyer of stocks or bonds must deposit with the stockbroker.

Marginal land. Land the produce of which pays only for the cost of utilizing the land.

Marginal producers. Producers whose income from the sale of goods produced equals only the cost of production.

Marginal productivity. The value of the productivity that may be ascribed to the marginal unit of production, the marginal unit being one of a given group of units that are alike.

Marginal utility. The utility of any of the units of a given stock of goods when the units are alike in every respect; or the utility of an additional unit.

Marginal worker. The last worker whom it is profitable to employ; a worker whose product is just equal to the amount of his wages.

Market. A meeting of buyers and sellers; a place where goods, securities, or services are bought and sold.

Market price. The price that is determined by supply and demand; the point of equilibrium between supply and demand.

Market ratio. The rate at which two commodities are exchanged for each other in the market; for example, gold and silver, at one time, exchanged at the rate of 16 to 1.

Marketing. Broadly speaking, all business activities other than those having to do with the direct production of form utility; business activities related to the buying and selling of goods.

Marketing co-operative. A co-operative organized for the purpose of marketing the products of its members.

Mediation. A method of settling labor disputes by means of discussion between employer and employees, assisted by a third party.

Medium of exchange. Anything that is used as a go-between in exchanging goods or services; money.

Merchant. A marketing agent who takes the title to goods.

Merchant guild. A medieval organization of merchants.

Merger. A combination of corporations involving the dissolution of one of them and the sale of its assets to a second corporation.

Middleman. One who engages in marketing activities.

Minimum wage. The lowest wage that may be paid under the law.

Mint ratio. Values fixed by the Government when two or more metals are used as the money standard—for example, silver and gold, 16 to 1.

Monetary. Pertaining to money.

Money. The medium of exchange used by an organized group of people.

Monometallic standard. The use of one metal as the standard for a monetary system.

Monopoly. Control by an individual, a business concern, a group, or government that makes it possible to fix the prices or control production of one or more articles or services.

Monopoly price. The price established by one producer or merchant or by a small group of producers or merchants who have the power to fix prices or to control supply.

Mortgage. A formal pledge of property for the payment of a debt.

Mortgage bond. A long-term promissory note secured by a mortgage.

Mutual savings bank. A savings bank owned by its depositors.

National income. When stated in terms of money, the total value of the annual national products.

Natural monopoly. An industry in which competition is not feasible.

Negotiable. The quality of being transferable to another by means of delivery or by endorsement and delivery.

Net Worth. Value of ownership; difference between total assets and total liabilities.

Noncumulative preferred stock. Preferred stock on which dividends are lost if they are not declared and paid in the year in which they are supposed to be earned.

Nondurable consumers' goods. Consumers' goods that are used up quickly.

Nonparticipating preferred stock. Preferred stock that does not entitle the holder to more than a stated amount of profits.

Nopar-value stock. Stock that has no money value stated in the stock certificate.

Normal price. Long-run price; price that tends to exist under free competition.

Occupational division of labor. Specialization of production according to occupations.

Open shop. An establishment where both nonunion and union workers may be employed.

Organized exchange. A place where securities or standardized commodities are bought and sold.

Participating preferred stock. Preferred stock that entitles the holder to share profits with the holders of common stock, usually after a stipulated amount has been paid to the holders of the common stock.

Partnership. The legal relationship between partners; a business enterprise that is owned by two or more persons who share in the management and in the profits and losses, but that is not a corporation.

Par-value stock. Stock that has a money value stated in the certificate.

Patent. Exclusive right conferred by government to make and to sell an article that one has invented.

Patronage dividend. A dividend paid by a co-operative society to its members in proportion to their purchases from the society.

Personal freedom. Quality or state of not being subject to arbitrary or external control.

Picketing. Method of discouraging others from working in a factory or from patronizing an establishment when employees are on strike.

Poll tax. Tax levied on an individual without reference to benefits received by him or to his ability to pay.

Pool. An agreement between producers to divide the business and profits within a given territory.

Preferred stock. Stock that entitles the holder to preferential treatment with respect to dividends or the distribution of assets, or to both.

Price. The exchange value of a commodity or a service stated in terms of money.

Price level. The value of money at one date as compared with that of another date expressed as a percentage.

Private corporation. A corporation that is subject to control by the members as stockholders and that is not owned by the government.

Private enterprise. A business that is owned and managed by a private individual or group, not a government undertaking.

Private property. The right to the exclusive control, within limits, of a good.

Producer. One who assists in making goods or services available for use.

Producers' co-operative. A co-operative organized for the purpose of production.

Product differentiation. A branded, trade-marked, or patented article.

Production. The creation of utility, or want-satisfying power, in goods or services.

Profit. Compensation for business risk; excess of receipts over expenditures.

Profit sharing. The sharing of the profits of a business concern with the employees, in addition to the payment of regular wages.

Progressive tax. A tax that grows proportionally more as the ability to pay taxes increases.

Promissory note. A written promise to pay.

Property. The right to use or dispose of a good or a service; the thing itself.

Proportional tax. A tax that increases at the same rate as the income or wealth.

Protection (foreign trade). The practice of discouraging by means of a tax or tariff the importation of goods made in foreign countries that can be sold in competition with goods produced by domestic producers.

Public corporation. A corporation that is organized for purposes of government; one that is owned by the government.

Public domain. All land owned by the government.

Public monopoly. A monopoly belonging to government.

Public property. The right of the government to the exclusive control of a good.

Public revenue. Income to the government that does not have to be repaid.

Public utility. A business concern that produces services that are essential to modern living conditions, the prices of which are fixed by government regulations rather than by competition. Public utilities enjoy a certain degree of monopoly owing to the fact that they must obtain a charter from the government.

Purchasing power parity. Rate of international exchange that is determined by the value or purchasing power of the money in the respective countries.

Pure profit. Profit remaining after allowances have been made for implicit rent, wages, and interest.

Pyramiding control. Control of producing companies by means of a holding company.

Quantity theory of money. The theory that the amount of money in circulation is the most important factor in the determination of prices.

Rate discrimination. Act of a public utility in charging more for one service than another.

Real wages. The amount of goods and services that money wages will buy.

Reciprocal trade agreements. Agreements authorized by Congress in 1934, providing for limited increases or decreases in tariffs by the President without Congressional action.

Rediscounting commercial paper. Reselling notes and drafts that have been discounted.

Regressive tax. A tax that grows proportionally less as the ability to pay taxes increases.

Rent. Compensation to the owner of land.

Reserve (banking). Money that is kept on hand for a possible need.

Retailer. One who sells to consumers.

Revenue. Funds that the Government collects but does not have to repay.

Risk bearing. Assuming the risks, or uncertainties, connected with the production and marketing of goods.

Sabotage. The damaging of machinery or goods by workers because of resentment against an employer. Any kind of restriction of output has on occasion been called sabotage.

Savings bank. A financial institution that accepts deposits, which ordinarily are left with the bank for a considerable length of time.

Scab. A name applied by strikers to those who apply for positions vacated by the strikers.

Secret partner. A partner who is unknown to the public.

Securities. Stocks and bonds.

Seigniorage. A charge for coinage that yields a profit to the government.

Services. Labor that in itself is useful in satisfying wants.

Severance taxes. Taxes on natural resources that are removed and sold.

Silent partner. A partner who takes no part in the management of the firm of which he is a member.

Single proprietorship. A business enterprise that is owned by an individual.

Single tax. A tax under which all rent would be appropriated for purposes of government and which, it is claimed, would render all other taxes unnecessary.

Sit-down strike. A strike in which the workers, instead of leaving the factory, simply stop work at a given time and remain in the factory.

Social insurance. Insurance supported by taxes.

Socialism. The doctrine that advocates the public ownership of productive capital.

Soviet. A unit of political and economic organizations in the Union of Soviet Socialist Republics (Russia), (U. S. S. R.).

Special assessment. Payment made by the owner of land to the government for improvements made by the government.

Specialized capital. Capital goods that can be used in but one or a few ways.

Specie. Metal money.

Speculation. Buying or selling with the aim of making a profit because of future changes in prices.

Standard money. The money in a monetary system upon which the value of all other money in the system is based.

Standard of living. Strictly speaking, the use of goods and services appropriate to the class level; an ideal. (**Scale of living** would usually be the more accurate term.)

Stock (corporation). The capital of a corporation in transferrable shares.

Stock certificate. An instrument certifying to the ownership of stock in a corporation.

Stock exchange. A place and organization for the buying and selling of corporation securities, stocks, and bonds.

Stock savings bank. A savings bank organized and conducted for profit by its stockholders.

Strike. The voluntary cessation of work by employees in order to enforce their demands on an employer.

Subjective value. The value that exists only in the mind of the person who is doing the valuing (not the same as utility).

Submarginal producers. Producers whose cost of production exceeds the income received from the sale of the goods produced.

Subsidiary company. A company whose stock is held by a holding company.

Subsidy. Money that is paid to a producer or other business concern to defray part of the cost of production or to increase profits on the theory that the business involved is of especial importance to the public.

Supply. The quantity of a particular commodity that will be offered at stated prices.

Surplus (corporate). The excess value of the assets over the amount of the liabilities and the issued capital stock; accumulated profits belonging to the stockholders.

Sympathetic strike. A strike that is called in order to help another group of workers, even though the strikers do not have any grievance of their own.

Syndicate. An agreement of several investment bankers by which they jointly undertake the sale of a large issue of bonds or stocks.

Tabular standard. A standard by which debt payments and wages would vary with changes in the price level.

Tariff. A tax, usually on imports.

Tax. A compulsory charge upon individuals or property, usually in the form of money, for the support of government

Technical division of labor. The division of labor within a productive establishment.

Technological unemployment. Unemployment caused by the introduction of labor-saving machinery.

Trade acceptance. A commercial draft drawn by the seller upon the buyer at the time of the sale of goods.

Trade agreement. An agreement, usually written, that sets forth the terms under which union workers are to be employed, including wages, hours, working conditions, order in which employees may be discharged, and so on.

Trade association. An organization of individuals and concerns engaged in similar kinds of business for the purpose of promoting the interest of the members.

Trade union. A labor union composed of members of a particular trade, as a carpenters' union.

True interest. An amount that will induce the owner of capital to forego the use of his capital until a later date.

Trust. An arrangement whereby the stockholders in competing corporations surrender their stock to a group of trustees receiving in exchange trust certificates.

Trust company. A financial institution that undertakes to administer estates and to perform other fiduciary duties.

Unearned increment. An increase in the value of property that is not due to the effort or expenditures of the owner.

Unemployment insurance. Insurance of employees against loss of pay due to unemployment, the cost of the insurance being provided by taxation.

Unfair competition. Methods of competition that disregard regulations imposed by law.

Union label. A label testifying that a product was made by union labor.

Utility. The quality of a good that enables the good to satisfy a want.

Value. The esteem placed upon a thing because of its utility; worth. (The term usually refers to exchange value.)

Value-of-service principle. Principle for determining public utility rates on the basis of what the service is worth to the user.

Variable costs. Costs that vary directly with the volume of production.

Velocity of money. The rate at which money changes hands.

Visible exports and imports. Exports and imports of commodities.

Volume of trade. The value of goods bought and sold during a given time.

Voluntary arbitration. The method of settlement when both sides agree to submit their difficulties to an individual or a group and to abide by the decision.

Watered stock. Stock that has been issued in exchange for property of less value than the par or the declared value of the stock.

Wealth. Material economic goods subject to ownership.

Wholesaler. One who sells to retailers or other middlemen.

Workmen's compensation. Compensation paid employees who are incapacitated, the cost being borne by the employers, who usually carry insurance.

Workmen's compensation laws. Laws for the purpose of compelling employers to carry the financial risk of accidents to employees when such accidents occur while the workers are employed.

"Yellow-dog" contract. A wage contract by which the employee agrees not to belong to a labor union.

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